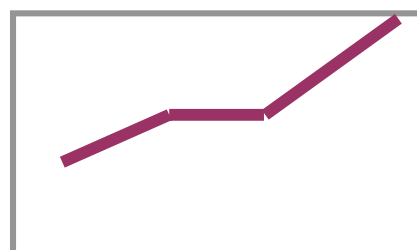




BULGARIAN ECONOMY IN THE SECOND QUARTER OF 2002



REPORT
OF
THE CENTER
FOR ECONOMIC
DEVELOPMENT

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ABBREVIATIONS USED

AIS	AGENCY FOR INSURANCE SUPERVISION
ASME	AGENCY FOR SMALL AND MEDIUM-SIZED ENTERPRISES
BAIT	BULGARIAN ASSOCIATION FOR INFORMATION TECHNOLOGY
BASCOM	BULGARIAN ASSOCIATION FOR INFORMATION TECHNOLOGIES
BATA	BULGARIAN ASSOCIATION OF TOUR AGENCIES
BIBA	BULGARIAN INTERNATIONAL BUSINESS ASSOCIATION
BMF	BULGARIAN MARINE FLEET
BNB	BULGARIAN NATIONAL BANK
BTC	BULGARIAN TELECOM COMPANY
CC	COMMERCIAL CODE
CCICMT	COORDINATING CENTER FOR INFORMATION, COMMUNICATION, AND MANAGEMENT TECHNOLOGIES
CEFTA	CENTRAL EUROPEAN FREE TRADE ASSOCIATION
CoM	COUNCIL OF MINISTERS
CPC	COMMISSION FOR PROTECTION OF COMPETITION
EC	EUROPEAN COMMISSION
EU	EUROPEAN UNION
GDP	GROSS DOMESTIC PRODUCT
GS	GOVERNMENT SECURITIES
GVA	GROSS VALUE ADDED
IBRD	INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
ICT	INFORMATION AND COMMUNICATION TECHNOLOGIES
IMF	INTERNATIONAL MONETARY FUND
MAF	MINISTRY OF AGRICULTURE AND FORESTS
ME	MINISTRY OF ECONOMY
MEER	MINISTRY OF ENERGY AND ENERGY RESOURCES
MFA	MINISTRY OF FOREIGN AFFAIRS
MH	MINISTRY OF HEALTHCARE
MLSP	MINISTRY OF LABOR AND SOCIAL POLICY
MoF	MINISTRY OF FINANCE
MoI	MINISTRY OF THE INTERIOR
MSSC	MANDATORY SOCIAL SECURITY CODE
MTC	MINISTRY OF TRANSPORT AND COMMUNICATIONS
NA	NATIONAL ASSEMBLY
NABM	NATIONAL ASSOCIATION OF BULGARIAN MUNICIPALITIES
NGOs	NON-GOVERNMENT ORGANIZATIONS
NHIF	NATIONAL HEALTH INSURANCE FUND
NSI	NATIONAL STATISTICS INSTITUTE
NSSI	NATIONAL SOCIAL SECURITY INSTITUTE
PA	PRIVATIZATION AGENCY
PPA	PUBLIC PROCUREMENT ACT
PPCA	PRIVATIZATION AND POST-PRIVATIZATION CONTROL ACT
PPF	PROFESSIONAL PENSION FUND
R & D	RESEARCH AND DEVELOPMENT
SERC	STATE ENERGY REGULATORY COMMISSION

SISA	STATE INSURANCE SUPERVISION AGENCY
SME	SMALL AND MEDIUM-SIZED ENTERPRISES
TINPA	TAXATION OF THE INCOME OF NATURAL PERSONS ACT
TPSMEA	TRANSFORMATION AND PRIVATIZATION OF STATE-OWNED AND MUNICIPAL ENTERPRISES ACT
VAT	VALUE ADDED TAX
VATA	VALUE ADDED TAX ACT
VPF	VOLUNTARY PENSION FUND
UN	UNITED NATIONS
UPF	UNIVERSAL PENSION FUND

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SUMMARY

The Bulgarian economy during the second quarter of 2002 did not confirm the trend of slowing down its growth observed at the end of the previous year. Macroeconomic stability persists, there is certain improvement of indicators such as industry dynamics, growth in the sector of services, business climate in the construction sector, inflation, balance of payments generally.

Nevertheless, the continued deterioration of the trade balance and the unsatisfactory volume of foreign direct investments increase apprehensions as to the mid-term prospects of Bulgarian economy. The situation in the labor market remains unfavorable. According to the representative survey of Bulgarian business, the business climate is neutral (neither good, nor bad) in the second quarter of 2002, but expectations of the future are lower now.

Business Climate in Bulgaria is evaluated employing the **Estat index**, which expresses a summarized estimate of the business climate in the country by the representatives of over 400 interviewed enterprises. In its substance, this index presents the dynamics of such a summarized estimate and is calculated by a uniform methodology every three months. The latest survey was conducted in the beginning of July. The **Estat Index** integrated estimate obtained as a result of survey data processing is a little lower than that registered for the previous quarter. The value is again within the neutral range of the valuation scale, which interprets the business climate as "neither favorable, nor unfavorable". Thus, in the beginning of the third quarter, the coming fall and winter months replace early summer optimism by more moderate forecasts. The actual condition of companies and the shortage of resources give grounds to interpret the advertised high tendency to invest as being rather desirable, like in the beginning of the second quarter. According to entrepreneurs, the major problems of the business environment remain bureaucracy, frequently changing legislation, unfair competition, and corruption.

For the period April - June NSI's overall business climate indicator is at relatively higher levels compared to the same months of the previous year, and its change is smoother.

The overall economic dynamics during the second quarter of 2002 is slowly improving. GDP growth is expected to be higher compared to the growth in the first quarter and closer to the values for the second quarter of the previous year. Services will contribute most to the general economic growth in the second quarter - these have a prevailing and growing share in GDP; there is also a trend of accelerating growth in this sector.

Industry development in the second quarter is improved compared to the first quarter of the year: Monthly indicators of industry sales and output improve, the business climate in the construction sector is good.

Deflation processes in the second quarter are explained (apart from usual seasonal lowering of the food prices) with shrinking demand and the cheaper dollar. Accumulated inflation from the beginning of the year till June dropped down to 1.1 percent. At the end of May the Government and IMF revised their forecasts for the annual inflation from 3.5 percent to 7.25

percent, with no changes in the other parameters of the budget framework required at this point. Inflation compared to June of the previous year is 5.2 percent on an annual basis.

In a short-term perspective economic agents will continue to readjust their market behavior in an environment of lower USD exchange rate. In our opinion, it is not sufficiently justifiable to say at this point that **the more expensive Lev** will have a negative impact on GDP growth in 2002. The cheaper dollar, other conditions being equal, slows down growth and export, but inflation as well. On the other hand, it improves the foreign debt/GDP ratio. Balancing buffers are the currency structures of commodity turnover (with dominating non-dollar export and dollar import) and of international reserves of BNB (the main portion of national reserves is maintained in EURO - at the end of 2001 over 80 percent of the market value of BNB's foreign currency assets were in the reserve EURO currency, 6 percent were in US Dollars).

In respect of the **labor market**, there are no significant changes of unemployment parameters in the second half of 2002. There is a drop of unemployment compared to the first quarter of the year, however within the usual seasonal cycle only. In the second half of 2002 unemployment remained at a level of 17 percent, with no noticeable improvement or beginning of higher seasonal labor demand observed. There is a trend of unnoticeable drop in the number of unemployed as a result of less massive layoffs and a certain boom in the private sector. Expectations for the second half of the year are towards relative stabilization of the labor market at the level of current parameters, notwithstanding the efforts of the Ministry of Labor and Social Policy to expand the scope and financing of active labor market measures. A major factor thereof is the disharmony of labor demand and supply, as well as uncompleted privatization and restructuring of a number of sectors and productions.

Overall, during the first six months of 2002 a good execution of the revenue part of the **budget** is observed. Concerning expenditures, the trend of their execution is similar to that in the first quarter of last year, with an observed drop of around 3 percent compared to the expenditures planned for the previous year. Similar to the corresponding half of 2001, the consolidated program reveals a surplus, which is greater than that for the corresponding half of 2001. Total subsidies transferred from the state budget to municipalities from the beginning of the year till June amount to over BGL 282.5 million or 38.75 percent of transfers to municipalities planned in the state budget.

Proposals for **tax policy** changes were announced in the second quarter of the year. These should take effect as of 1st January, 2003. On the whole intentions can be assessed as positive, but discussions and specification of individual provisions still lie ahead. In the beginning of June the Government declared its intentions for amendment of the Constitution to delegate tax powers to municipalities. The VAT-account took effect as of 1st August 2002. The VAT refunding period under such accounts was cut down to 45 days. Chapter 10, Tax Policy, of Bulgaria's negotiations for accession to EU was closed.

As of the end of June the total amount of **government and government guaranteed debt** was BGL 18 855 m., or 61.3 percent of the Gross Domestic Product (according to updated estimates of the latter by the Ministry of Finance). Compared to the end of the previous quarter the total amount of debt is decreased by about BGL 2 004 m., mainly as a result of the cheaper dollar compared to the EURO. There is also serious improvement of the debt/GDP(estimate) ratio. However the dollar equivalent of the total amount of government and government guaranteed debt increased by USD 312 m. from the end of first quarter till the end

of June 2002. Along with the higher price of the dollar compared to the EURO, this is also due to the changed foreign currency structure of the debt, mainly as a result of the accounted March replacement and buy back of Brady Bonds.

Total amount of **foreign debt** increased by USD 199.3 m. from the end of March till the end of June. According to end of June estimates total amount of foreign debt is USD 8 622.3 m. (or BGL 16 906 m.). Beyond the repeatedly declared objective to improve the foreign debt/GDP ratio (given Bulgarian government debt structure, this ratio is of key importance for achieving the Maastricht criteria), there are not any indications yet as to the availability or preparation of any long-term management strategy particularly for the Bulgarian foreign debt.

According to data of the Ministry of Finance, as at the end of June **domestic debt** amounted to BGL 1 949 m. (including government debt of BGL 1 945 m. and internal government guarantees of BGL 3.9 m.). The total amount of domestic debt increased by BGL 32 m. compared to the end of the first quarter of 2002. The second quarter revealed a different yield dynamics of short-term and long-term government securities compared to the first quarter. The share of government securities issued to finance the budget deficit increased whereas the share of government securities issues for the structural reform decreased. In a short-term perspective the basic trends of the recent months will persist - increased share and relative expenses of government securities issued to finance budget deficit and gradual extension of the maturity structure of said securities. With the continuing increase of the net issue of government securities in BGL and extension of their maturity, certain yield growth, particularly on new issues of long-term government securities, is expected.

The pace of **privatization** in the state sector remains unsatisfactory in terms of the number of transactions made in the period under review. Sixty eight transactions were made in the first quarter of the year (51 for shares and interest in whole enterprises and 17 for detached parts), whereas in the second quarter the transactions were only 8 (6 for whole enterprises and 2 for detached parts). The total financial effect thereof reached USD 115.471 m. (including agreed payments of USD 99.083), with contribution of the last 8 transactions amounting to USD 16.659 m. As at mid-2002 the privatization plan was fulfilled at 19.5 percent in terms of the number of transactions, and at around 31 percent in terms of agreed payments. There is certain progress with regard to the preparation and adoption of the secondary legislation on the application of the Privatization and Post-privatization Control Act.

In the area of **small and medium-sized enterprises**, the inter-departmental work group at ASME on optimization of regulatory procedures to improve the administrative and regulatory environment for doing business made a review of 361 procedures and resolved on amending 191 (repealing 73 and facilitating 120) procedures. A start was given to building a Public Register of Regulatory Procedures. Despite the launched discussions on the government tax policy till 2005, at this point there are not any particular intentions to implement a tax policy targeted at SME sector support, while it is this field that generates most problems for the small business. In June the Agency for Small and Medium-sized Enterprises organized a coordinating meeting of donors, government administration and non-government organizations supporting SMEs. Another event is also worth mentioning in an analytical perspective - the Report on Bulgarian SMEs-2001 was published.

The development of **foreign economic relations** is influenced by the relatively slow pace of recovery of world economy, which does not generate consumer demand growth and does not

create sufficient favorable conditions for growth of Bulgarian export. What is more, the major export market - the European Union - recovers at lower than the average pace. At the same time, the weak dollar increases competition at international markets and makes Bulgarian export products less competitive; it encourages import and creates threats to the already big balance of trade deficit, which continues to increase. Given the comparatively regular inflow of foreign direct investments, the improved current account in the second quarter is totally a result of the positive balance of trade in services. The lower current account deficit reduces the threat to the financial stability of the country, but, given the high relative share of foreign direct investments in the total volume of fixed capital investments, real economic growth remains strongly dependable on their inflow.

In the period April - June the country exported products to the amount of USD 1254.5 m., representing an increase of 4.5 percent compared to the first quarter of the year and 1.7 percent compared to the same period of 2001. Yet on the whole the export to the amount of USD 2454.4, realized during the first half of the year, is by 2.4 percent less than the value of export realized for the same period of 2001. In the second quarter of 2002 import increased by 17.3 percent compared to the first quarter and reached USD 1840.4. Increase compared to the second quarter of 2001 is only 0.6 percent, and for the first half of the year there is even decrease of the value of import by 1.5 percent compared to the same period of the previous year. In terms of export commodity structure, the share of prime and raw materials is higher compared to the first quarter, mainly as a result of the higher prices of basic export products such as steel, copper, and carbamid. The increase in the export of investment goods is also interesting. In the second quarter of 2002 the export of consumer goods decreased by 2.1 percent compared to the first quarter, mainly as a result of the decreased export of clothes and shoes. With regard to the geographical structure of export, the share of EU (nearly 57 percent) continues to increase, yet in terms of value there is a small decrease of around 0.6 percent compared to the period January - June 2001. The **balance of trade deficit** increases, reaching -USD 954.8 for the first half of the year (calculated at FOB export and CIF import terms). In the second quarter of 2002 the negative trade balance increased by 58.8 percent compared to the first quarter, but marked a decrease of 1.6 percent compared to the second quarter of 2001.

Given the continuing for a second year trend of slower investment processes as a result of the cyclic economic decline, the limited inflow of **foreign direct investments** to Bulgaria since the beginning of 2002 seems logical. Yet the drop in foreign investments observed in the country since the beginning of the year is mainly a result of local factors. In the second quarter attracted investments amounted to USD 112.6 m. and approached the revised investment amount of USD 116.8 for the first quarter, revealing a permanent trend of decreased investments, which started as early as the second quarter of the previous year.

Government **policy in the energy sector** is manifested above all in the new Bulgarian Energy Strategy adopted by the Council of Ministers in April 2002. The Strategy outlines the basic energy policy objectives and defines the instruments of their achievement. It provides greater degree of transparency of government actions and makes the business environment in the country clearer for potential investors. Along these lines is also the indicative schedule of increasing the price of electricity for households in the next three years. Realization of Government intentions for withdrawal of the state from its ownership functions and conferring the latter to the private sector as a condition for competition, more efficient resource

management and improved technological and management level of enterprise in the sector is gradually gaining momentum.

The decreasing **prices of energy products** at international markets, combined with lower dollar exchange rate and real actions to rebalance tariffs among various consumer groups, created market and regulatory conditions for more favorable prices of energy supplies to the real sector. The positive effect was most strong for refineries and Bulgargas EAD, and their major clients will feel it with a certain time lag. Better prices of energy supplies to enterprises have indirect impact on households through lower prices of oil products and other non-energy but highly energy intensive goods. This effect is neutralized, however, by the increased prices of electricity and heat for households (at an average of 20 percent and 11.4 percent respectively), which again caused uneasiness among people as to price reform acceptability. The introduced two-step tariffs where households pay fixed quantities of electricity and heat at lower prices are a positive step towards a more rational use of energy resources, however these should be accompanied by a large-scale and well-directed information campaign.

In the second quarter of 2002 the **transport** sector did not witness any actions towards substantially improved efficiency of both the sector itself and the benefits its services generate to other sectors. Yet a number of measures like the progress in the preparation for upgrading of Sofia Airport and the construction of a second bridge over the Danube river will have a positive effect on Bulgarian business in the mid-term.

An important event in the **information and communication technologies** (ICT) sector in the second quarter of 2002 is the completed first phase of the privatization of BTC. There are three candidates for the national telecom, but before final offers are filed in September one can hardly judge the advantages of its privatization for Bulgaria. An important step in the ICT policy is the development of an e-Government Strategy. Its completion is expected by the end of the year and it will mark the end of the first phase of e-Government introduction.

Against a background of unfavorable international environment for **tourism**, summer season anticipations are optimistic for Bulgaria. In the second quarter of the year there is an increase of the number of foreign tourists in the country and a rise in revenues from tourism. Most significant is the increase of tourists from EU, Germany in particular. Revenues from tourism increased by USD 28 m. compared to the same period of the previous year. At the same time, there is also an increase of the foreign trips and expenditures of Bulgarian nationals. In the second quarter net revenues from tourism increased by USD 22 m. compared to the same period of the previous year. A new Tourism Act was adopted in June and will take effect as of 1st October 2002. It aims at improving the legal framework for development of tourism. Problems facing tourism are still mostly related to the poor condition of general infrastructure in resorts, unregulated relations with concessionaires of beaches, absence of efficient advertising policy aimed at attracting foreign tourists.

Agrarian policy aims at increasing investments in agriculture under the SAPARD Program; supporting production by way of credit lines, target subsidies and investment programs of the State Agriculture Fund; encouraging export by way of export subsidies; supporting farmers in the implementation of European standards of food quality and safety, environment protection and creation of new jobs. Rather good crop and good export opportunities are expected, but the poor weather conditions have unfavorable impact on yield and quality.

The role of the **capital market** in the financial sector of Bulgaria remains insignificant – at the end of June 2002 the total market capitalization of the Bulgarian Stock Exchange – Sofia AD was slightly above 4 percent of the up-dated projection (BNB and IMF estimates) of GDP for 2002. Liquidity remains low, the market does not encourage good corporate governance practices, and investment alternatives remain limited. Financial intermediation is still provided mostly through the banking sector. Nevertheless, the second quarter of the year marked a positive development in several of the major market indicators characterizing the condition of the capital market in Bulgaria. Parallel drop down of volumes and capitalization with increased turnover generally reveals a trend of ownership consolidation and concentration of trade on a smaller number of issues at the expense of dropping down liquidity of the majority of quoted securities. In July, immediately after the end of the second quarter, the Council of Ministers adopted an annual list of 1073 companies with state interest, mostly minority one, shares wherein can be sold (by different privatization methods, public offering via the stock exchange included) against compensatory instruments and investment vouchers. Some pieces of secondary legislation regulating the issue of and transactions in compensatory instruments were adopted. The adoption of Amendments to the Act on Public Offering of Securities can be assessed as a positive government policy event. Nevertheless, along with the objective situation in the capital market, the review of the development environment and the government policy itself generates hesitant assessments. In 2002 expectations of market development are still focused on the prospects for privatization via the stock exchange and particularly on the entirely new regulation of transactions in compensatory instruments.

The **banking system** dominates the financial sector in Bulgaria. The condition of banks in Bulgaria is still characterized as continuously stable, with excellent measures of capital adequacy and liquidity, and availability of well functioning bank supervision. Foreign participation in the banking system of Bulgaria is predominant in both equity control and assets under management. Generally, the banking system marks a drop down of assets and deposits in the second quarter, which however is accompanied by increased current profit. The latter indicates underutilized potential for more intensive and more efficient development. Despite the stability in the banking system of Bulgaria, however, trends are contradictory and the system remains barely efficient and underdeveloped. Notwithstanding the objective indicators of a trend of improvement, lending activity in support of enterprises, including small and medium-sized ones, is still assessed as low.

In the field of **social security and pension reform**, the idea of the Ministry of Labor and Social Policy and NSSI to introduce minimum security thresholds by sectors and professions is an attempt to solve the problem of the continuously growing deficit in the Pension Fund. This project is expected to generate positive results, which, however, are mostly dependable on the future good faith and correctness of employers. The Ministry of Finance outlined the procedure of investing abroad the assets of pension insurance companies and supplementary pension insurance funds, however legal limitations on investments in foreign assets and the absence of sufficiently attractive investment instruments still force voluntary pension funds to invest mainly in securities issued and guaranteed by the Government and in bank deposits in the country.

The hopes of most Bulgarians for appreciably higher standards of living, categorically voiced at the 2001 parliamentary elections, have not been realized yet. There is a stagnation in the **nominal incomes** of the population, with real income lagging behind inflation rates compared to the same period of the previous year. Consumers' expectations for the next twelve months

are for deteriorated economic situation in the country and financial situation of households, as well as for unfavorable changes in inflation and unemployment.

There was much more tension in the **Government - trade unions - employers relationship** compared to the first quarter of the year. Some unregulated labor and social issues, as well as the desire of the trade unions to take more active part in political life were the cause of trade union protests and demonstrations. Social tension will be generated in the future as well, given the discussions on amendments to the Labor Code, optimization of government expenditures in education and healthcare, and the continuing privatization and restructuring.

The **healthcare reform** remains in a standstill. The absence of clear policy aimed at promoting private health insurance, controlling the management and expenditure of NHIF assets, and privatization of medical institutions, outlines unfavorable trends in the healthcare sector. In the second quarter of the year discussions in the healthcare sector were mainly focused on solving the free medicines issue, increasing the control of NHIF, and introducing rules for the privatization of medical institutions, but no considerable practical actions were observed.

In the second quarter, the analysis of the **environmental policy** was focused on latest official data about the environmental situation in the Republic of Bulgaria, including in relation to amendments to environmental legislation important for the business environment and the economic activity of companies. Although environmental data cover a period well before the quarter we analyze, certain trends observed in that period are directly related to the actions of government institutions in the recent months. In 2002, still no operating platform existed for constructive and efficient dialogue between government structures and national business associations on the priorities of the general investment and corporate policy on environment protection and recovery.

In the context of the adopted Strategy for Accelerated **Accession Negotiations with EU**, Bulgarian Government continued its active policy of negotiations; 6 new chapters were closed by the end of the Spanish Presidency, thereby closed chapters reaching 20 in total. To summarize the negotiation results, they entered a new, final phase, which justifies the conclusion of the European Commission that Bulgaria has achieved progress in its preparation for accession. Closing the chapters "Economic and Monetary Union", "Free Movement of Goods", "Free Movement of Persons" and "Tax Policy" marks the achieved progress in establishing functioning market economy in Bulgaria and outlines the prospect of the future accession to the Euro-zone. The Copenhagen message in the beginning of the Danish Presidency is of special importance to the motivation of Bulgarian society. During the Danish Presidency our country should close another five negotiation chapters: "Fiscal Control", "Customs Control", "Transport", "Justice and Home Affairs", and "Energy"; and the last five chapters should be closed by the middle of 2003, within the Greek Presidency.

The development of Bulgarian economy in the second quarter of 2002 was also accompanied by certain changes in **other elements of the business environment**. Amendments to the Public Procurement Act were published in April. These were called for by the need to: take into account EC positions and regulations, create more favorable conditions for promotion of competition, and increase the efficiency in the fulfillment of public procurement orders. The May decision of the Council of Ministers to repeal or ease some licensing procedures is the first step towards reducing the existing administrative barriers and eliminating one of the sources of corruption. The decision, however, is one of principle; it should be materialized in

specific primary and secondary legislation documents, and that will obviously be a long and difficult process. The State Aids Act took effect; a regulation on its application was also adopted. This was in response to a basic point of EU's criticism towards Bulgaria - the absence of control on the provision of state aid and of monitoring of its spending. In the beginning of June the Government approved the Rules of Procedure of the Anti-Corruption Commission set up in February; the Parliament started discussions on an Ombudsman bill. The Amendments to the Judiciary System Act were adopted at first reading in June (the text finally adopted in July). The basic objective of the Amendments is to make the work of law-enforcement institutions maximally transparent to the public, because a closed judiciary system is a fertile field for corruption.

The Estat Index of Business Climate

The Estat Index expressing a summarized estimate of the business climate remains in the neutral portion of the valuation scale. In the beginning of the third quarter, the coming fall and winter months replace early summer optimism by more pessimistic forecasts. The actual condition of companies and the shortage of resources give grounds to interpret the advertised high degree of tendency to invest rather as desirable, like in the beginning of the second quarter. According to entrepreneurs, the major problems of the business environment remain bureaucracy, frequently changing legislation, unfair competition, and corruption.

The latest survey was conducted between 1st and 10th July 2002 and involved 388 companies. The sample is representative at the level of going concerns. Selection criteria for sample companies involve: region, sector, number of employees, and type of ownership.

The index methodology and the mathematical model are developed by the **Estat Agency for Social and Market Studies**.

The integrated estimate obtained as a result of the data processing of the business climate survey is – 1.56, which is by 0.562 lower than the value registered in May. The value is again within the neutral portion of the valuation scale, according to which the condition of business climate can be defined as neither favorable, nor unfavorable.

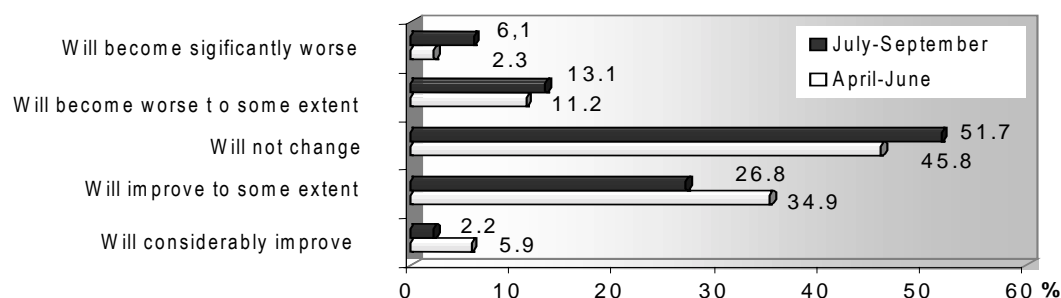
The scale employed to interpret the index is with a range of -100 up to +100 points and is divided in five equal ranges. Ranges thus defined practically exclude transferability from one category to another on the basis of random factors. The first and the second **Estat Index** values fell within the -20 +20 range. Due to the great width of ranges, the negative sign is mainly of psychological significance.

The integrated indicator comprises three components. Component I “General Condition of the Company”, Component II “Investment Attitudes and Corporate Strategies”, and Component III “Business Environment”.

The slightly lower index value is mainly due to certain “sobering up” of business, manifested in lower expectations for the future. The clearly expressed optimism of the first quarter gives place to a rather neutral to pessimistic forecast - the share of company managers who expect their situation to improve in the next three months decreased by over 12 per cent. (Figure 1).

Figure 1.

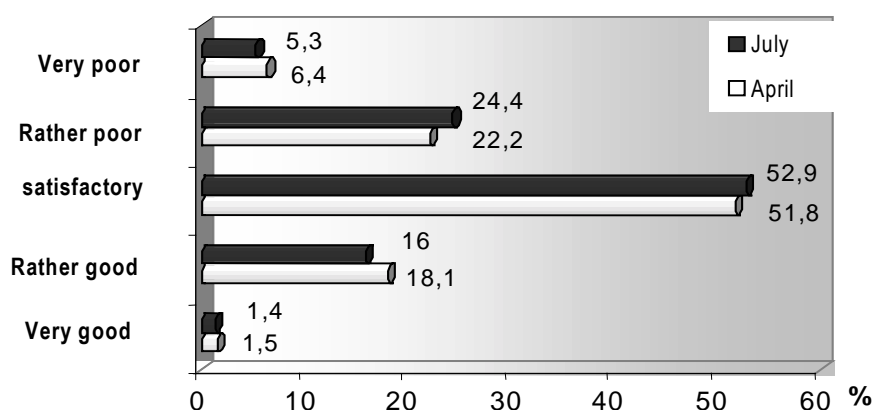
In your opinion, will the state of your business change over the months?



The assessment of the snapshot condition of companies is not very favorable, either - every fourth interviewed evaluates it as rather poor, and every second as satisfactory (Figure 2). The estimate is practically the same as in the beginning of the second quarter.

Figure 2.

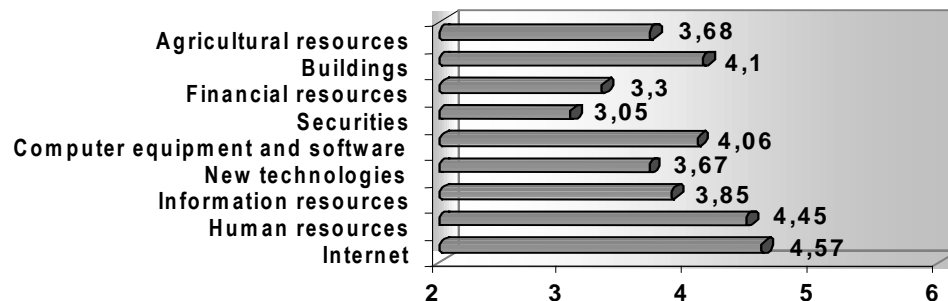
How do you assess the current state of your business?



The tendency to invest remains high, despite the fact that 67 percent of the businessmen say they experience shortage of financial resources in their business, generally estimating as average (3.30 on a scale of 2 to 6) available cash resources.

A tendency to overestimate against competitors one's own capacity and level of development persists, although estimates of the actual condition and available resources of a company are not high (Figure 3).

Figure 3.
Average Estimates of Available Resources in Companies



Business Environment

In the second quarter the assessment of government policy, legislation, tax system, and administration remains negative. The data of the business survey conducted in July confirm certain conclusions and expert assessments formulated in the analysis. The main conclusion is that conditions for doing business have not changed and remain the same as in the first quarter. It should be taken into account that the period is very short - three months only, and, as a rule, it is not realistic to expect significant changes. Results for the business environment are similar to those for the previous quarter.

Entrepreneurs give the same ranking of major business environment problems - difficulties with the central administration, existing administrative barriers and obstacles to the start up of new business, opportunities to evade taxes, unfair competition, problems with the application in practice of regulations.

At the same time assessments indicate some positive change in certain parameters of the environment. The question is about regulatory changes aimed at facilitating the business; results are still expected, but the declaration of these changes itself has some, although small, positive effect. (it might be a purely psychological one). These changes are along the following lines.

Administrative barriers and start up of new business

An important problem, which was outlined in the surveys in both the first and the second quarter, concerns the start up of new business and the existing administrative barriers. Seventy-four percent of the interviewed in the July survey agree that administrative barriers are a major problem for the business. In April 79 percent of the interviewed agreed with this statement. Regarding the start up of new business, 83 percent of the interviewed stated in April that it was definitely difficult, while in July respondents that fully agreed with this statement dropped down to 75 per cent. A possible explanation is the fact that in May the Government resolved to repeal 74 and ease another 120 licensing procedures. However, the

effect of this resolution lies in the future as it has to be formulated in specific regulatory documents. Nevertheless, it is this announcement that probably generates greater optimism in this field. Yet on the whole, despite the decreased percentage of definitely negative answers, a large part of the respondents still think that administrative barriers (licensing, permits, coordinating procedures, etc.) create serious problems to entrepreneurs.

Institutions and Government

The assessment of the government policy for encouraging entrepreneurship remains generally negative. Nearly 60 percent of the respondents are of the opinion that the Government does not implement sufficient measures to encourage business. Yet the share of entrepreneurs who rather agree that the Government makes efforts to encourage entrepreneurship increased from 9 percent to 14 percent.

The conclusions as to the problems generated by the frequent change of legislation and the difficulties in its application in practice are confirmed (the share of the respondents who think that legislation is changed too often increased from 84 percent to 87 percent). There are also facts that support this perception, the amendments to the Public Procurement Act for example. There was objective need of these amendments with a view to comply with EC regulations, but at the same time it was announced that an entirely new Public Procurement Act will be developed in 2003. Such circumstances create problems. Application of regulations in practice also generates ambiguities and difficulties, however the share of entrepreneurs who think that application in practice creates problems dropped down from 79 percent to 73 percent.

The share of respondents who give a positive answer to the question of "whether legislation creates equal opportunities for all economic actors" increased from 17 percent to 19 percent. A major commitment of the Government was to place business in the center of economic policy and to create equal opportunities for balanced development of small, big, and medium-sized businesses. The opinion of the interviewed economic actors reveals that this commitment is not successfully fulfilled yet.

Relationship with the Central Administration

Assessments of the relationship with the central administration and of the opportunities for corruption remain negative. Over 60 percent of the respondents fully agree that business is quick and efficient when you "know somebody in the government administration". There are some grounds for optimism here, because this percentage dropped down compared to April when 71 percent of the interviewed gave categorical answer to this question. A similar conclusion can be made when analyzing the answers to the question about the readiness to bribe. The share of the respondents who categorically answer that they would pay some additional money decreased from 50 percent to 44 percent. One cannot speak of a change, but there are indications that an environment intolerable to corruption could be created.

Assessments of the efficiency and unbiasedness of the judiciary system remain negative. The share of the respondents who think that litigations are not determined fairly remains high. Only 15 percent of the interviewed actually think that the court would be unbiased in determining a case.

Competition in the Domestic Market

Most of the interviewed in July think that unfair competition remains widespread. The share of the respondents who believe that unfair competition impedes normal business development increased. Eighty five percent of the interviewed give positive answer to this question, whereas in April this percentage was 79. This result confirms again the need to improve the protection of competition. (The Government envisages amendments to the Competition Protection Act.) Nearly half of the respondents assess as rather negative the protection of intellectual property and property rights. However some positive trend is observed. The share of those who agree that the protection of property rights is inefficient decreased from 54 percent to 47 percent. The percentage of the interviewed who still believe that the procedures of assignment and implementation of public procurement orders are not transparent and clear is high.

Banking System

The positive assessments of the stability and reliability of the banking system are confirmed (the share of the respondents who fully support this statement increased from 35 percent to 40 percent). Yet the problems associated with the banks' readiness to provide loans remain; the share of the entrepreneurs who would borrow a bank loan for investment dropped from 67 percent to 59 percent.

The opinion of the business confirms the objective indicators for the banking system. The situation of Bulgarian banks is assessed as stable, with excellent capital adequacy and liquidity parameters. At the same time, despite the existing upward trend, the lending activity of banks in support of enterprises, including small and medium-sized ones, remains poor.

Tax Environment

Tax policy issues outline the following situation: in April 80 percent of the entrepreneurs thought that tax rates were high and made companies evade taxes. In July the share of the interviewed who thought that tax rates generated tax evasion decreased by 10 percentage points and reached 70 percent. This might be partly a result of the tax policy based on the principle of reducing the general tax burden, while maintaining low the budget deficit (reducing the profit tax rate, the maximum personal income taxation rate). There is certain "dispersal" of estimates in the assessment of the profit tax - 35 percent of the July respondents assessed the profit tax as rather tolerable, while in April 27 per cent of the interviewed were of such opinion. In the second quarter the share of the respondents who fully agree with the statement that the patent duty is overtax for companies decreased (from 41.4 percent to 26.9 percent).

One cannot say that the patent duty definitely constitutes a major problem for the business (50 per cent of the interviewed agree with this statement).

The general opinion of respondents is that Bulgarian tax system prevents business from making investments and taking risk and does not create equal conditions for all companies.

Policy for Promotion of Innovations and Technological Development

The Government policy on promotion of high technology is an important issue, directly concerning business environment and R & D. Unfortunately over half of the interviewed think

that the Government is not implementing policies in support of R & D and application of high technologies. As little as 16 percent of the respondents firmly believe that the Government policy in this field is a promoting one.

European Integration

Answers to the question about the harmonization of Bulgarian legislation with that of EU are very interesting - in April 55 percent of the interviewed thought that the harmonization process would improve the conditions for doing business in Bulgaria, while in July their number dropped down to 53 percent. Sixteen percent of the respondents stand of the opinion that this process will not have a favorable effect on the business. This circumstance confirms the need of a well-directed policy to prepare Bulgarian business for EU membership. There is not sufficient information about the risks, neither about possible benefits from the harmonization of the legislation - more clear rules and procedures, more intensive competition, more opportunities for participation in international markets, more incentives to improve the quality of goods and services produced, etc.

Investment Attitude and Corporate Strategies

Like in the first quarter, the tendency to invest is rather of a declarative nature as it does not correspond to the real capacity of companies in terms of available financial resources. The share of entrepreneurs who would take a bank loan to make investments has decreased by over 10 percentage points, but remains high (almost 60 percent).

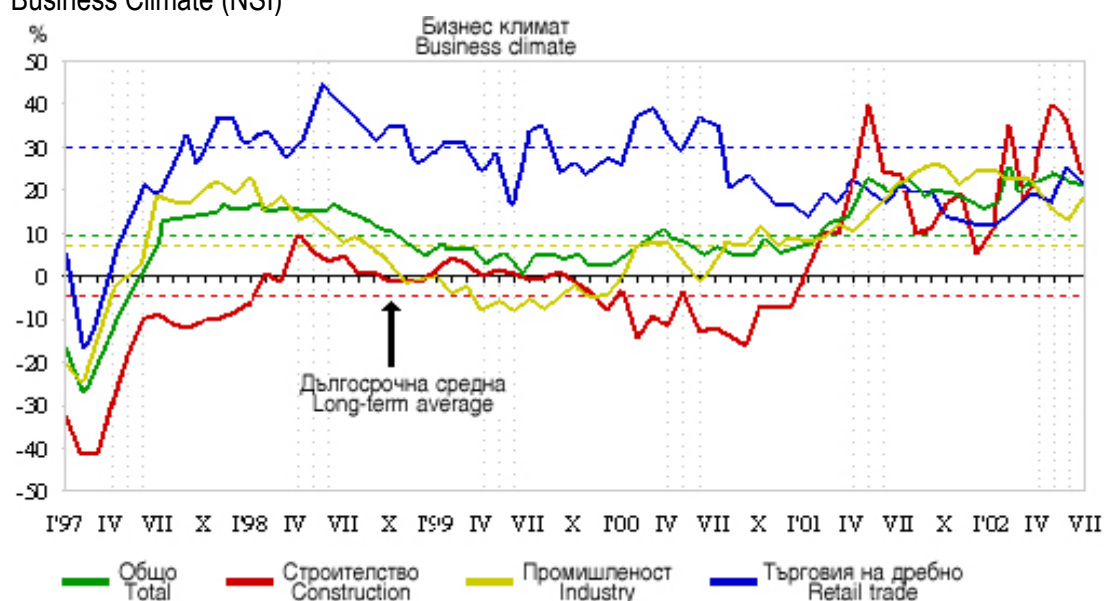
96 percent of the interviewed entrepreneurs share that they continuously control the quality of their products and services and have a developed business strategy, regularly up-dated.

NSI's Business Surveys

NSI's monthly business surveys register a higher value of the general business climate indicator in April and May 2002¹, entirely as a result of the improved business climate in the construction sector. In June 2002 the value of the overall business climate indicator decreased, though negligibly (by 0.7 percentage points), compared to May. For the period April - June the overall business climate indicator remains at higher values compared to the same months of the previous year, with smoother variations.

¹ The overall business climate indicator calculated by NSI is a weighted arithmetical mean of three branch business climate indicators: those of industry, construction, and retail trade

Figure 4.
Business Climate (NSI)



Source: NSI

Industry

The industrial business climate indicator manifested a downward trend from the beginning of the year till June, mainly as a result of the lower estimates of the current business situation. In April managers' assessments of current production activity and level of orders went upward, going down in May and in June. Limited domestic and foreign demand remains a main problem for industry. In May problems of companies related to competitive import and the uncertainty of economic environment increased and remained dominant in June. Yet in June, in contrast to the lower estimates of the level of export orders, the assessments of the level of domestic orders mark certain improvement. According to NSI's investment business survey, in April industrial enterprises stated expectations of nominal increase of their investments for 2002 by around 21 percent compared to 2001.

Construction

The business climate in the construction sector has improved since April, and in June, despite the slight decline of the indicator as a result of the lower managers' estimates of the current business situation, the economic situation in the sector remains quite favourable.

Since March the balance of estimates of current construction activity has increased, marking a slight decline in June. Till April the level of orders in construction indicator reveals a smooth downward trend, going upwards in May and keeping the level in June. Problems resulting from clients' insolvency and insufficient demand increased, which, together with the maintained high levels of uncertainty about the economic environment, explains the slowed down dynamics of the construction sector in the beginning of the summer.

Retail Trade

Since January “the business climate in retail trade” has improved, and despite the slight decline of this indicator in May, in June it reaches its highest level since the beginning of the year. Expectations of sales in the next months, which have been positive since the beginning of the year, quickly rise. But a coming slow down of trade is prompted by estimates of orders to suppliers, which mark a decline in June. Demand is the major long-range factor preventing the improving of the business situation in the enterprises of the sector, followed by competition, which outstripped demand in June. This most probably means that in Bulgaria competition disturbs the non-competitive rather than stimulating them to become competitive.

Services (trade excluded)

Since May 2002 NSI conducts a harmonized monthly business survey of the services sector. Two observations available reveal that **estimates of the current business situation given by enterprises in the services sector and the expectations of these enterprises for the next 6 months are positive**. Anticipations about total demand in the service sector, although lower compared to May, remain positive. In June the demand of services, mostly in the “hotels and restaurants”, “land transport”, “posts and telecommunications”, “private education” areas, increased compared to May.

ECONOMIC DYNAMICS

Gross Domestic Product

GDP growth in the second quarter of 2002 is expected to be higher compared to its growth in the first quarter and will approach the growth in the second quarter of previous year. Services will contribute mostly to the general economic growth in the second quarter of 2002 - their share of GDP is dominant and growing; there is also a trend of accelerating growth in this sector.

Table 1.

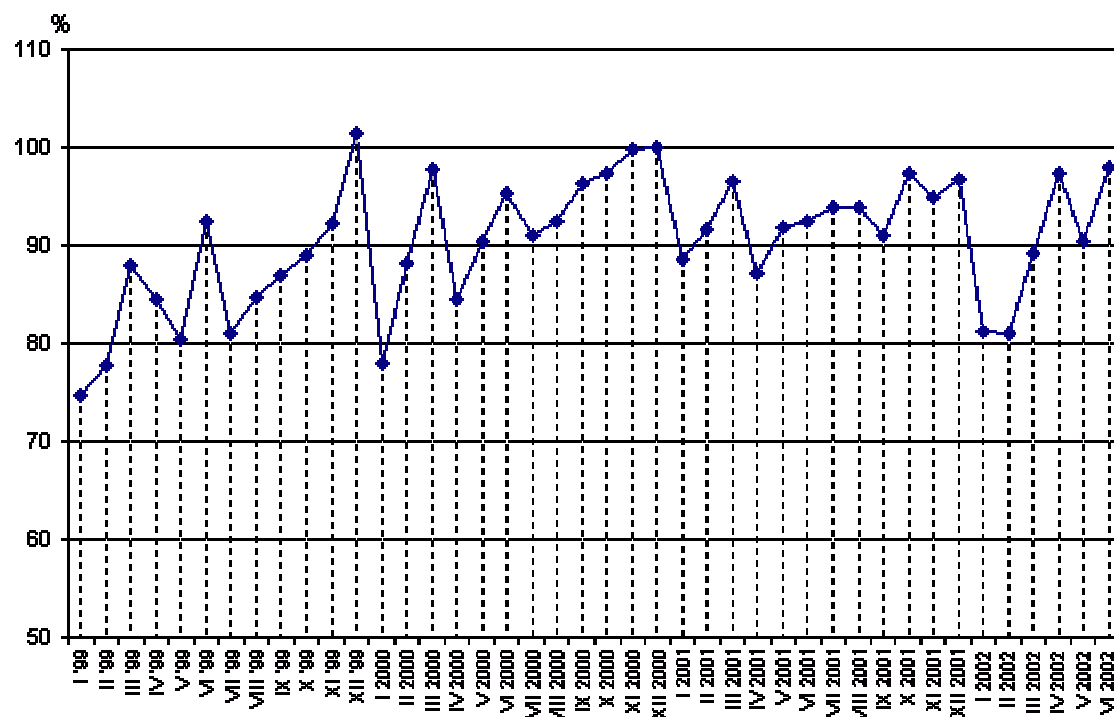
Gross Domestic Product, Volume Indices, corresponding period of previous year = 100, %

	Q1 2001	Q2 2001	Q3 2001	Q4 2001	Q1 2002
Production					
Gross Value Added, total	103.2	103.7	104	103.8	104.3
Gross Value Added, agriculture	92.8	99.9	102.9	100.7	102.7
Gross Value Added, industry	106.6	103.9	105.7	101	100.5
Gross Value Added, services	102.9	104.3	103.5	105.8	106.6
GDP	104	104.1	103.9	104.2	103.2
Final use					
Final Consumption	103	105.8	102.9	106.3	103.6
Individual Consumption	103.6	104.6	102.8	106.9	104.1
Collective Consumption	98.6	117.1	103.4	102	99.6
Investments (GFCF)	117.2	115.5	115	129.4	104.5
Exports of Goods and Services	114.2	109.6	113.6	96.9	95.6
Imports of Goods and Services	107.7	115.5	122.9	106.5	101.2

Source: NSI

In the second quarter industrial development is more favourable than in the first quarter of the year: the monthly indicators of industry sales and output have improved, but remain unstable; the situation in the construction sector is favourable (see Appendix 1). We expect a higher growth of industry value added on an annual basis compared to the minimum growth in the first quarter of 2002 - in April, May, and June industry output is higher than in the same months of last year, the average monthly level of industry sales has also improved.

Figure 5
*Monthly Sale Indices of Industrial Enterprises**



*Average monthly sales of 1997 = 100

Source: NSI

Inflation

The accumulated inflation rate from the beginning of the year till June dropped down to 1.1 percent after three consecutive deflations since April. At the end of May the Government and IMF revised their annual inflation projections from 3.5 to 7.25, with no changes in the other parameters of the budget framework required at this point. Inflation compared to June of the previous year is 5.2 percent on an annual basis.

Deflation processes in the second quarter are explained (apart from usual seasonal lowering of the food prices) with shrinking demand (also indicated by NSI's business surveys) and the cheaper dollar. Due to the lower dollar exchange rate, in June prices of liquid fuels and diesel oil dropped down by 2 percent, and those of coal and motor vehicles fuel - by 2.2 percent. The June deflation of 1.7 percent is mainly a result of the drop down of food prices by 3.7 percent and of other commodities prices by 0.3 percent. Prices of services remained at the level of the previous month.

Administrative influence on price levels will remain a major domestic pro-inflation factor because of the Government commitments to international financial institutions, which involve a 50 percent rise of electricity prices in the next three years.

The trend of appreciation of the Lev to the US Dollar will have positive and negative effects on the economy and on individual economic agents. Benefits are for those who cover expenses in BGN fixed in US Dollars, for example:

- fiscal benefits as a result of decreased BGN on-budget expenditures for payments in US Dollars (dollar government debt service, dollar import of goods and services, etc.). Released assets are a reserve for more flexible operation of budgetary activities.
- benefits for the business as a result of decreased BGN expenditures for dollar import of energy resources, raw materials, investment and consumer goods. Released assets are a reserve for branching out. Adequate pricing is a prerequisite for ad hoc preservation or improvement of competitiveness. The effect is anti-inflationary in a macroeconomic perspective.

Negative effects are for those who cover in BGN revenues fixed in US dollars, for example:

- negative effects for the business are generated mainly by the lower BGN equivalent of dollar export and the relative appreciation of the Bulgarian product as a result of the depreciation of the competitive import product, in case of shrinking domestic demand of this product. The initial effect is lower competitiveness of Bulgarian dollar exporters and lower competitiveness at the domestic market of Bulgarian products against the dollar import; a secondary effect is a tendency to recover competitiveness by optimization of production costs. In a macroeconomic aspect such effects will be most painful for employment and hired labor income.
- negative effects for economic agents as a result of the smaller BGN equivalent of dollar transfers in Bulgaria.

In a short-term perspective economic agents will continue to readjust their market behavior in an environment of lower USD exchange rate. **In our opinion, it is not sufficiently justifiable to say at this point that the more expensive Lev will have a negative impact on GDP growth in 2002.** The cheaper dollar, other conditions being equal, slows down growth and export, but inflation as well. On the other hand, this improves the foreign debt/GDP ratio and according to some estimates the government and government guaranteed debt/GDP ratio may drop down below 60% in the months to come. Balancing buffers are the currency structures of commodity turnover (with dominating non-dollar export and dollar import) and of foreign currency reserves (the basic portion of national reserves is maintained in EURO - at the end of 2001 over 80 percent of the market value of BNB's foreign currency assets were in the reserve EURO currency, 6 percent were in US Dollars).

Labor market

There are no significant changes of unemployment parameters in the second quarter of 2002. There is a drop of unemployment compared to the first quarter of the year, however within the usual seasonal cycle only.

According to results of the NSI's sampling survey of the labor force, **in June the number of unemployed but willing to work individuals at the age between 15 and 64 who are not active job-seekers increased compared to March** (from 529.2 thousand to 531.5 thousand).

A lasting problem of the labor market is the lack of correspondence between supply and demand. A survey conducted by the Ministry of Labor established that 70 percent of all unemployed have primary education. In our opinion the established increasing tendency of employers with high qualification requirements to hire university students is positive. This might decrease the inflow of young unemployed or the outflow of young people abroad, but it does not solve the problems of the unemployed who cannot be offered appropriate jobs. The basic

challenge of labor policy is to find specific mechanisms of effective support to make various groups of unemployed people more competitive in the labor market.

Since July the Employment Agency will be calculating the “unemployment level (unemployed/economically active population)” indicator using data about the economically active population from the census taken by the National Statistical Institute in March 2001. According to that census the economically active population dropped down to 3 704 336 people (by 118 633 people or 3.1 percent) compared to the previous census taken in 1992 (3 822 969 people).

Table 2.

Unemployment. Comparative Table

		June 2001	March 2002	June 2002
The Employment Agency calculates the “unemployment level” indicator according to the methodology of ILO as the percentage ratio of the number of unemployed people in a given month and the economically active population according to the census taken by NSI.	Registered unemployed, in thousands	654	669	659
	Economically active population, according to the census taken in 2001, in thousands	3704.3	3704.3	3704.3
	Unemployment, %	17.7	18.1	17.8
NSI calculates an unemployment coefficient (unemployment level) as a ratio of the data about the number of unemployed people and the number of the economically active population, obtained from each individual labor force monitoring.	People who have defined themselves as unemployed, in thousands	661.1	641.7	599.2
	Economically active population, according to labor force monitoring (NSI), in thousands	3412.6	3291.5	3399.7
	Unemployment, %	19.4	19.5	17.6

Source: Employment Agency, National Statistical Institute

Second quarter of 2002 budget

Consolidated budget (it covers the national budget and the legislature budget)

On the whole, the execution of budgetary revenues in the first six months of 2002 is good. It is too early yet to speak of lower collectability. Lower revenues compared to the same period of last year could be a result of the lower income tax effective as of 1st January 2002. Concerning expenditures, the trend of their execution remains similar to that for the first six months of the previous year, with an observed drop of around 3 percent compared to the expenditures planned for the previous year. Similar to the corresponding half of 2001, the consolidated program reveals a surplus, which is greater than that for the corresponding half of 2001.

Consolidated budget revenues for the first six months of 2002 amount to BGL 6 086.9 m. or 48.84 percent of the annual amount of the consolidated budget program revenues, whereas the amount for the same period of 2001 was BGL 6 062.1 m. (53.05 percent of the 2001 program). **Expenditures** amount to BGL 5 777.7 m. or 45.42 percent of the annual amount of program expenditures, with BGL 5 895.1 m. for June 2001 (49.74 percent of the annual amount under the last year program). As of 30 June 2002 the report on the implementation the consolidated budget reveals a surplus to the amount of BGL 309.1 m., with a surplus of BGL 176.0 m. for the same period of 2001.

National budget (it comprises a central budget and the budgets of the government agencies)

As of 30th June 2002 **the national budget reveals a surplus** to the amount of BGL 181.8 m., whereas the implementation of the budget for the period till June last year revealed a deficit to the amount of BGL 175.7 m. Revenues amount to BGL 3 556.7 m. or 50.94 percent of the envisaged annual amount, with BGL 3 65.7 m. for the same period of last year or 53.62 percent of the program. **Expenditures** amount to BGL 3 374.8 m. or 44.82 percent of the envisaged annual amount, with BGL 3 541.5 m. for the same period of 2001 or 49.65 percent of the program.

The central budget reveals a surplus for the first quarter of the year to the amount of BGL 57.2 m., with revenues amounting to BGL 2 851.6 m. and expenditures - to BGL 2 794.3 m.

Municipalities

At the end of June representatives of the National Association of Bulgarian Municipalities (NABM) and the Ministry of Finance agreed upon **the program for covering unsettled expenditures of municipalities**. The latter closed last year accounts with a deficit of BGL 124 m. The program consists of two parts. The first will prove the amount of unsettled expenses and the factors that determine them, by sources. Municipalities will receive regular transfers, which will be dependent on the indebtedness of each municipality and on the implementation of the national budget for the six months and for the nine months of the year. Transfers for unsettled expenditures for municipal activities are expected in December.

In the beginning of July the Ministry of Finance transferred to municipalities the general subsidy for June to the amount of BGL 3 866 800. Thus the total subsidy provided from the beginning of the year till the end of the second quarter amounts to over BGL 202.5 m., or 38.75 percent of the planned transfers to municipalities under the national budget program. This amount also includes the general subsidy of BGL 18 219 400 remitted in fulfillment of the Program for gradual reduction and liquidation of unsettled expenditures of municipalities for 2002. The target subsidy for relief payments, provided to municipalities in June, amounts to BGL 11 201 200. The total target subsidy for relief payments exceeds BGL 79.5 m by the end of June. Thus, from the beginning of the year till the end of June the Ministry of Finance remitted to municipalities subsidies to the amount of over BGL 282 m.

Taxes and Duties

Proposals for tax policy changes announced in the second quarter of the year are a major event in the field of taxation. These should take effect as of 1st January, 2003. Overall, these intentions can be assessed as positive, but discussions and specification of individual provisions still lie ahead. Some basic specific measures in tax legislation include:

The Ministry of Finance makes **a proposal for introduction of a single profit tax rate** of 23.5 percent and for abolition of the municipal tax. As of the beginning of next year profit tax revenues should be fully paid to the national budget, and revenues under TINPA - mostly to municipal budgets. as of the beginning of next year companies investing in regions with level of unemployment which is over 50 percent higher than the average for the country should pay profit tax at a rate of 15 percent, and not 23.5 percent. Incentives are envisaged also for investment companies - the latter will no longer pay profit tax on proceeds from the sale and purchase of shares; only dividends paid by such companies shall be taxable.

Increasing the annual depreciation rate for: computers and software from 20 percent to 50 percent and taking these out of the group of accelerated depreciation assets; group II assets - machinery, production equipment, cars and outfit - from 20 percent to 30 percent, without application of the accelerated depreciation method; group III assets – transport vehicles, road and runway tracking, from 5 to 10 percent.

The Taxation of the Income of Natural Persons Act envisages gradual reduction of the tax burden for the lower rate from 18 percent to 15 percent in 2003, from 15 percent to 12 percent in 2004, and down to 10 percent in 2005. In 2003 average rates should be reduced each by 2 percentage points, from 24 percent and 28 percent to 22 percent and 26 percent respectively. An entirely new taxation scale for the income of natural persons should be introduced.

The Excise Duty Act envisages abolition of the excise duty on wine and increasing the excise duty on alcoholic beverages from BGL 0.035 to BGL 0.05 per degree of alcohol. Increasing the excise duty for filter cigarettes from BGL 0.002 per cigarette plus 40 percent of the selling price to BGL 0.003 per cigarette plus 42 percent of the selling price by 2004. Increasing the excise duty on leaded gasoline: with octane level below 98 - from BGL 300/ton to BGL 350/ton, with octane level 98 and above - from BGL 500/ton to BGL 550/ton. Increasing the excise duty on unleaded gasoline: with octane level beyond 98 - from BGL 300/ton to BGL 350/ton, with octane level 98 and above - from BGL 500/ton to BGL 550/ton.

In the beginning of June the Government declared **its intentions for amendment of the Constitution to delegate tax powers to municipalities** as from the next year. Municipalities will be able to determine the types, rates, abatements, and fully administer local taxes and charges. Proposals for amendment of the Constitution are included in the program for financial decentralization of municipalities approved by the Council of Ministers in the beginning of June. This will also allow municipalities to introduce new taxes.

VAT-accounts took effect as of 1st August 2002 by way of an addendum to the Regulation on the Application of the Value Added Tax Act. Amendments to the Regulations on the application of VATA allow companies to make use of VAT accounts which are mandatory to open but voluntary to use. Till now bona fide taxpayers suffered from the provisions of the Tax Procedure Code envisaging that the administration may refuse to refund VAT where a predecessor in the chain has been proven wrong. The period of VAT refunding under such accounts is reduced to 45 days. Whether the VAT-account mechanism will help to curb budget draining via VAT will become clear after its implementation.

A further proposal of the Ministry of Finance is to exempt from VAT the import of equipment for implementation of investment projects, on the condition that the total value of the project exceeds BGL 10 million. The privilege to get refunded 65 percent of the tax credit for tour operators' services sold abroad should also be valid for hotel-keepers who do not hold tour operator's license.

Chapter 10, Tax Policy, of the negotiations for accession to EU was closed. In the beginning of June the Ministry of Finance announced that within the accelerated preparation for EU membership Bulgaria has made progress in the negotiations on Chapter 10, Tax Policy, opened on 27th July 2001, and temporary closed negotiations on this chapter.

Bulgaria has largely adopted and applies EU legislation in the field of taxation. The country does not envisage material changes upon the coming into force and application of the other corresponding legislation till the date of its accession to EU, except where transitional periods have been requested and accepted. Such cases include: concerning VAT Bulgaria has negotiated exemption from the requirement for a minimum threshold of BGL 10 000 for mandatory VAT registration, while reserving the right to apply a higher threshold after accession; concerning international transportation of passengers, Bulgaria has negotiated the right to further apply VAT exemption with a right to tax credit for that part of transportation which is carried on the territory of the country and is a taxable transaction under EU requirements; concerning excise duties, an exception to EU general rules has been negotiated, which allows Bulgaria to apply a reduced rate, but not lower than 50 percent of the standard excise duty rate, on quantities of alcoholic drinks of up to 30 l per household, made of fruit and grapes of domestic production by natural persons in specialized small distilleries, and intended for personal consumption only.

Following the date of accession Bulgaria will be allowed a 3-year transitional period for application of the new EU legislation whereby new minimum excise duty rates for cigarettes are introduced. That will allow the country to gradually achieve the minimum levels of EU excise duty rates across a longer time period. Bulgaria has developed in its negotiation position and the additional information papers attached thereto a detailed schedule for gradual harmonization of Bulgarian tax legislation with that of EU, implementation whereof is a priority of Bulgarian tax policy.

Customs revenues preserve an upward trend for the first six months. In the first half of 2002 the Customs Agency collected net revenues from duties, VAT, excise duties and fines, sanctions, interest on imported goods, which exceed by BGL 65 672 714 the amount for the same period of last year. In June total revenues amount to BGL 204 883 449. As of the beginning of the year payments by the customs administration to the national budget amount to BGL 1 256 660 381, compared to BGL 1 190 987 667 for the same period of 2001.

Foreign and domestic debt

As of the end of June the total government and government guaranteed debt amounts to BGL 18 855 m. or 61.3 percent of the Gross Domestic Product (GDP) (according to the updated estimates for the latter as per data of the Ministry of Finance). **Total debt decrease compared to the previous quarter is BGL 2 004 m.**, which is mainly a result of the depreciated dollar against the EURO. There is also serious improvement of the debt/GDP(estimate) ratio compared to the end of March when this ratio was 67.8 percent (Ministry of Finance data).

However the dollar equivalent of the total amount of government and government guaranteed debt increased by USD 312 m. from the end of first quarter till the end of June 2002 (from USD 9 304 m. to USD 9 616 m. according to BNB's central rates of exchange for the corresponding days). Along with the higher price of the dollar compared to the EURO, this is also due to the changed foreign currency structure of the debt, mainly as a result of the accounted March replacement and buy back of Brady Bonds. As at the end of March 2002 the debt denominated in dollars amounted to 62.99 percent of the total government and government guaranteed debt, whereas at the end of June the dollar debt is 51.86 percent. For reference, the share of the debt denominated in EURO increased from 16.65 percent of total amount as at the end of March to 27.25 percent as at the end of June (the Lev debt also marks an increase within the debt structure from 5.82 percent as at the end of March to 6.94 percent as at the end of June 2002).

In the coming third quarter of the year the debt amount will be very likely determined foremost by the EURO/dollar exchange rate dynamics. However, the debt/GDP (estimate) ratio indicator remains important, as this ratio will probably improve further.

Foreign Debt

The new active policy of foreign debt management was first manifested in the buyback of external debt Brady bonds and the placement in November 2001 of Eurobonds with a nominal value of EUR 250 million and a maturity on 1st March 2007.

Beyond the repeatedly declared objective to improve the foreign debt/GDP ratio (given Bulgarian government debt structure, this ratio is of key importance for achieving the Maastricht criteria), **there are not any indications yet as to the availability or preparation of any long-term management strategy particularly for the Bulgarian foreign debt.** Concerning active current politics, the first quarter of 2002 witnessed the last for now evidence of this new foreign debt policy. A large-scale operation of external debt Brady bonds replacement with new global eurobonds was performed in March. The operation included simultaneous buyback of Brady bonds, their direct replacement by eurobonds in USD or

denominated in EUR, as well as a net issue of such eurobonds. The summary results of the Ministry of Finance reveal a net reduction of Bulgaria's nominal debt by USD 80 million, release of a guarantee of USD 197 million and savings of USD 94 million on a net present value basis. Brady bonds with a total nominal value of nearly USD 1327 million have been replaced. The new issue of USD bonds are with a nominal value of over USD 513 million, maturity in 2015, interest coupon of 8.25 percent on an annual basis, with two annual interest payments and a yield to maturity of 9.1 percent on an annual basis. The new issue of eurobonds denominated in EUR is with a nominal value of EUR 835 million, maturity in 2013, interest coupon of 7.5 percent on an annual basis, one annual interest payment and a yield to maturity of 7.987 percent on an annual basis.

According to data by the Ministry of Finance, as at the end of March 2002 the external debt structure included a debt in eurobonds of USD 218.1 million and Brady bonds to the amount of USD 4 742.9 million. **In the second quarter of 2002 the specific results of the transaction were reflected in the foreign debt dynamics indicators.** As at the end of June Bulgarian debt in eurobonds (denominated in EUR and USD) amounts to a total of USD 1 594.3 m., revealing an increase of USD 1 376.2 compared to the end of the previous quarter (Ministry of Finance data).

On the other hand, in the second quarter of 2002 Bulgarian foreign debt in Brady bonds decreased by USD 1 326.3 m (from USD 4 742.9 m to USD 3 416.6 m.). The dynamics of the foreign debt in Euro bonds and other bonds is neutralized by the positions expressing credits and government guaranteed debt as foreign debt components. Consequently, **from the end of March till the end of June the total amount of Bulgarian foreign debt increased by USD 199.3 m. According to end of June estimates, total foreign debt amounts to USD 8 622.3, or BGL 16 906,** recalculated at BNB's central BGL/USD exchange rate on 28 June 2002 (including USD 8 095.9 m. of government debt and USD 526.4 m. of government guaranteed debt).

Data about the last month are provisional. With a view to achieve comparability with past periods, the above data about the external debt amount are based on information by the Ministry of Finance and do not include commercial loans in the gross external debt statistics (according to the new methodology of BNB).

In April, May, and June the Treasury made foreign debt payments amounting to a total of USD 192.1 m., with received loans of USD 32.3 m. Payments include payments of principal amounting to USD 156.5 m. and payments of interest amounting to USD 35.6 m.

Domestic debt

According to data by the Ministry of Finance, the total domestic debt as at the end of June amounts to BGL 1 949 m. (including BGL 1 945 m. of government debt and BGL 3.9 m. of internal government guarantees). The total domestic debt increase is BGL 32 m. compared to the end of the first quarter of 2002.

Concerning domestic debt structure, as at the end of June the debt share in government securities issued to finance the budget deficit is 65.08 percent (61.13 percent at the end of the first quarter) of the total domestic debt amount. As at the end of June the debt share in

government securities issued for the structural reform is 34.72 percent (38.58 percent at the end of March) of the total domestic debt amount. The share of internal government guarantees in the total domestic debt amount is 0.20 percent as at the end of June (0.29 percent at the end of the first quarter of 2002). Table 3 illustrates the dynamics of the total volume of domestic debt structure.

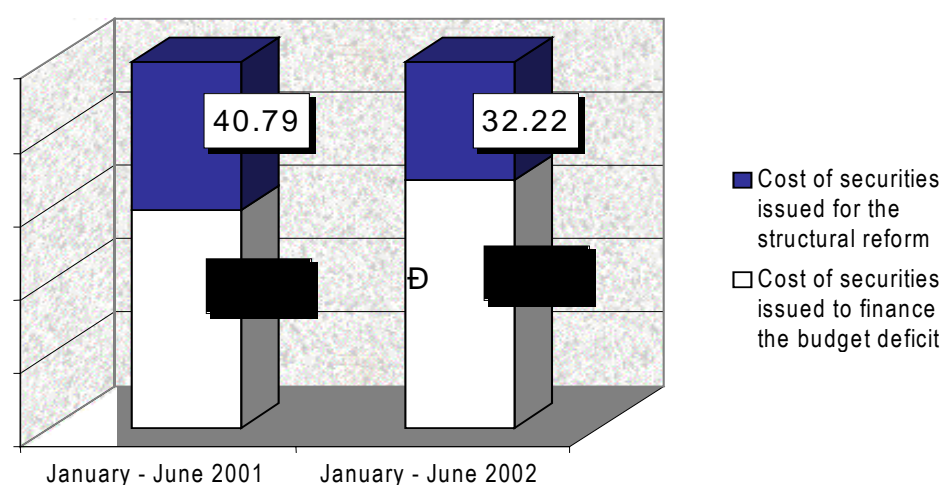
Table 3
Total Volume of Domestic Debt Structure

Debt Structure	End of June 2001	End of March 2002	End of June 2002
Debt in government securities issued to finance deficit	53.28	61.13	65.08
Debt in government securities issued for the structural reform	46.20	38.58	34.72
Internal government guarantees	0.52	0.29	0.20

Source: MoF, Government Debt monthly newsletter

Total domestic debt expenditures (interest and discount) for the first six months of 2002 amount to BGL 54.8 m. (BGL 62.5 m. for the corresponding period of 2001, excluding expenditures for the direct payables to BNB accounted for till March 2001). The share of expenditures for government securities issued to finance the budget deficit is 67.78 percent (59.21 percent of total domestic debt expenditures for the first six months of 2001, direct payables to BNB excluded), and the share of expenditures for government securities issued for the structural reform is 32.22 percent (40.79 percent of total domestic debt expenditures for the six months of 2001, direct payables to BNB excluded). Figure 6 illustrates the dynamics of domestic debt expenditures structure in the first six months of 2001 and 2002 respectively.

Figure 6.
Domestic Debt Cost Structure



Source: MoF, Government Debt monthly bulletins

According to data by BNB (Government Securities Market bulletin of the Fiscal Services Division), in the period April - June 2002 the average primary market yield of the new issue of government securities for financing of the budget deficit was 3.90 percent on an annual basis for three-month notes (three auctions for the period), 5.19 percent for twelve-month notes (one auction for the period), 5.88 percent for three-year treasury bonds (one auction for the period), 7.10 percent for seven-year bonds (one auction for the period), and 7.95 percent for ten-year bonds (three auctions for the period)

Thus, in respect of the domestic debt **the second quarter reveals different dynamics of the yield of both short-term and long-term government securities, compared to the first quarter. There is an increase of the share of securities issued to finance the budget deficit and a decrease of the share of securities issued for the structural reform, compared to the first quarter.** Compared to the first quarter of 2001, the share of expenditures for government securities issued to finance the deficit has increased, whereas the share of expenditures for securities issued for the structural reform has decreased. This is a direct result of the changed domestic debt structure.

In the short term the basic trends of the recent months will persist - increased share and relative expenses of government securities issued to finance budget deficit and gradual extension of the average maturity of issues in circulation, calculated on the basis of the maturity structure of said securities. With the continuing increase of the net issue of government securities in BGL and extension of their maturity, certain yield growth, particularly on new issues of long-term government securities, is expected.

Domestic debt dynamics already suggests an active policy of debt management, similar to the discussed new external debt management policy. Again it is not clear yet whether this is part of some long-term debt management strategy, however the more vigorous behavior of the Ministry of Finance since the beginning of the year resulted in some surprises and in a need of new conduct on the part of many actors of the Bulgarian money market.

The actions of the Ministry of Finance and the absence of a debt strategy are considered in terms of the purely market effect, but also in the more general context of state government efficiency. The recommendations contained in the published at the end of June report of the National Audit Office on the audit of internal government debt origin and management and debt instruments use in 2001, conducted in the ministry, could be given such interpretation.

Recommendations of the National Audit Office are along three lines. In the first place, a new unit should be set up within the Ministry of Finance to take special care of domestic debt management. In the second place, the National Audit Office insists on adoption of a Government Debt Act regulating debt origin and management. The Government Debt Bill was passed by the National Assembly on a first readings in February, but it has not been passed on a second reading and enforced yet. Finally, the report of the National Audit Office states that the ministry's administration must better determine the maturity of the new security issues with a view to smoother distribution of the burden of domestic debt management across the years to come.

The pace of privatization in the state sector remains unsatisfactory in terms of the number of transactions made in the period under review. Sixty eight² transactions were made in the first quarter of the year (51 for shares and interest in whole enterprises and 17 for detached parts), whereas in the second quarter the transactions were only 8 (6 for whole enterprises and 2 for detached parts). The total financial effect thereof reached USD 115.471 m³ (including agreed payments of USD 99.083), with contribution of the last 8 transactions amounting to USD 16.659 m. The 2002 State-Owned Enterprises Privatization Plan⁴ sets out as minimum privatization objectives 349 transactions, including 238 for majority shares and blocks of stocks, 21 for minority shares, 90 for detached parts of enterprises. Privatization of another 315 residual shares and blocks of stocks connected to transactions already signed is also envisaged. Expected revenues (agreed payments) from the transactions signed in 2002 are estimated at BGL 748 493 000 (in all legal payment instruments), including cash revenues to the amount of BGL 618 523 000. **Program fulfillment obviously lags behind. As at mid-2002 the privatization plan was fulfilled at 19.5 percent in terms of the number of transactions, and at around 31 percent in terms of agreed payments. Transactions with foreign investors were not signed in the second quarter.**⁵

In the second quarter the initial phases of the tenders (filing of indicative offers) for the **expected big transactions - BTC, DZI, Bulgartabac** - were completed and at the end of June the period for preparation of final offers by candidate buyers was already running for the last two. **The procedures for BTC and Bulgartabac generated blames of non-transparency** as a result of the delayed announcement of candidate buyers in the first case and of candidates who had paid deposits for participation in the next phase in the second case. The first case was explained with PA's unwillingness to create conditions for first company's candidates to come to an agreement among themselves, whereas in the procedure for the second company the set up of partnerships was encouraged, with the method being the same in both cases - a tender. Besides, it was explained in the second case that confirmations by banks as to actually paid deposits were expected for several days, which generated suspicions that any candidate had not managed to comply with the stipulated period and had tacitly conceded points.

Concerning the privatization of Bulgartabac, there are a number of factors that complicate the forthcoming transaction. In the first place, this is the decision, laid down in the privatization strategy, not to divide the two types of activities carried on by the holding company - tobacco processing and cigarette production - and not to allow possible sale of individual factories outside the holding company. Thereby the number of potential investors was reduced, putting off those who were interested in individual activities or production units only. The decision has its objective prerequisites. Such a prerequisite was extensively commented and explained - Government's desire to keep the present structure of the holding by preserving not only the few profitable enterprises, which are most attractive for investors, but also the other companies that are less attractive at this point. Thus most current jobs would

² Data by PA, http://www.priv.government.bg/ap/bg/06/062/pic/4GTRANSall_b2_2_2002.jpg

³ Data by PA, http://www.priv.government.bg/ap/bg/06/062/pic/1AP_plast_b93_2002_1.jpg

⁴ PA site, <http://www.priv.government.bg/cgi-bin/ap/07/loader.cgi?k=0>, replacing 2002 State-Owned Enterprises Privatization Program, Official Gazette, No. 108/14 december 2001, in accordance with the new APPC

⁵ Data by PA, <http://www.priv.government.bg/ap/bg/06/063/pic/5schiB.html>

be preserved and the purchase of Bulgarian producers' tobacco would be guaranteed - these two arguments are of material social significance. The other prerequisite remained somewhat outside the focus of public attention - the present capital ownership structure of the holding, resulting from the privatization scheme adopted some time ago for the holding. Bulgartabac is a public company and part of its shares were sold in the first voucher privatization campaign and then traded at the Bulgarian Stock Exchange. It is obviously quite difficult and time-consuming to set up daughter companies by simply reducing the holding's capital with the amount of the holding's share in the capital of such companies, as that would generate fair protests for damaged interests by the other minority shareholders outside the state. The other option, which is more reasonable for all shareholders, involves purchase by the state of the shares of the daughter companies in the holding, but that would incur excessive expenses for the state and the privatization scheme would be too complex and slow again. Thus the easier option is obviously to sell the holding as it is, but with no great interest on the part of investors. The repeatedly announced restitution claims of Russia on part of the holding's assets present another factor of unfavorable effect on the privatization procedure. The official position of the Government has been that the claims are unfounded, but the announcement itself has a negative effect on potential buyers as it creates uncertainty about the way out of the problem in case of possible determination by court. PA has already declared the Tobacco Capital Partners Consortium supported by Deutsche Bank the successful candidate.

Another transaction also attracted public attention during the period - **the tender for the assets of Varna Shipyard JSC**. It was realized under the Commercial Code and not under PPCA as the company was in a bankruptcy procedure following several unsuccessful attempts for its privatization as a going concern. Nevertheless, the transaction bears relation to the privatization process, as the buyer is **Bulgarian Marine Shipping Company JSC**, which is currently a 100 percent state-owned enterprise in the course of preparation for privatization. The 1999 and 2000 profit of BMF is below BGL 600 000, and the purchase price of Varna Shipyard, which is in a grave financial condition, is BGL 35.5 m.⁶ secured under a loan agreement. **This transaction changes materially the current situation of BMF, making the privatization of the company more complicated as a scheme:** there are two enterprises now and the investment involves higher risk because time and considerable additional investments are needed to complete the ships under construction in the shipyard. The best way out would be resale of Varna Shipyard before the privatization of BMF.

There is certain progress in the development and adoption of the secondary legislation on the application of the Privatization and Post-privatization Control Act. The following regulations took effect in June: Regulation on the Assigning of Activities Related to the Preparation for Privatization or to Post-privatization Control, Including Procedural Representation; Regulation on the Procedure of Allocating and Spending Funds of the Covering the Privatization Expenditures Fund with the Privatization Agency; Regulation on the Legal Status Analyses and Privatization Valuations and on the Licensing of Evaluators; Decree of the Council of Ministers No. 116/6 June 2002 regulating the relations regarding the closing of the Center for Mass Privatization.

It should be noted that at the end of the first quarter the exact mechanism of utilization of issued investment vouchers was not regulated yet, and according to § 22 of the Transitional and Final Provisions of PPCA vouchers are valid till 30 September 2002. Only the

⁶ MoF data, <http://www.mi.government.bg/news.html?id=1728>

2002 Work Plan⁷ of the Privatization Agency mentions the option of selling blocks of stocks of non-public companies by way of centralized public auctions but says nothing about who and when will organize and carry out the auctions.

The Act on Transactions in Compensatory Instruments was adopted in May. The Regulation on Tenders effective as of March is also valid under the new Act.

The start up of the new Agency for Post-Privatization Control was delayed because by the end of June the National Assembly had not elected its Supervisory Board yet (according to PPCA the Board was to be elected within one month after the act had took effect). The Supervisory Board must also draw up and adopt the By-law of the institution. The lists of companies shares wherein will be sold by way of public offering at the stock exchange against compensatory instruments or payment in cash were not fully specified yet. There were some problems with the privatization of banks, which are not privatized yet because of a technical omission made upon the passing of PPCA and, unlike medical establishments, they were not taken out of its regulatory scope. Most likely, the omission will have to be removed by way of an amendment to PPCA.

The amendments to the Code of Civil Procedure, whereby the Prosecution is allowed to refute the validity of privatization transactions already signed, and the request of the Prosecution for refuting the validity of seven specific transactions gave rise to active public debates. The opinion that such actions **would have a negative effect on the general investment climate** in the country and would discourage both local and foreign buyers willing to take part in privatization prevailed. Even now there is a legal opportunity to refute the validity of transactions where violations of effective legislation have been established or where the buyer has not fulfilled his commitments under the privatization contract where that is provided for in the contract. Thus, along with the serious risk of unexpected claims towards the new owners for an unlimited future period of time, posed by the elimination under the new PPCA of the limitation whereby creditors are given six months following the start of the privatization procedure for a company to claim their receivables (under paragraph 6a of the Transitional and Final Provisions of the repealed TPSMEA), another factor generating uncertainty among investors has appeared. The combination of these two factors : will lower investment activity along privatization lines, which is not very intensive altogether; will have unfavorable effect on prices of future transactions; and, in the long run, will make a number of enterprises unable to survive and will face the state with the obligation to make excessive unintended expenses to compensate the buyers, not getting in return any material benefits.⁸

⁷ PA site, <http://www.priv.government.bg/cgi-bin/ap/07/loader.cgi?k=0>

⁸ See E. Radeva's comments on the subject of 3 July 2002, <http://www.econ.bg/advice.html?type=3&lang=1&id=5000>

The achievements of the inter-departmental work group at ASME on optimization of regulatory procedures to improve the administrative and regulatory environment for doing business⁹ were an important event in the period. The group made a review of **361 procedures and resolved on amending 191 (repealing 73 and facilitating 120) procedures**. A start was given to **building a Public Register of Regulatory Procedures**. Efforts for **drawing up a bill on the regulation of economic activity** continued within an administrative barriers reduction project financed by the British Government and with the participation of foreign consultants. Some major principles contained therein include: licensing procedures should be regulated in primary legislation only, and not in secondary legislation, issued licenses should be termless; certification should be valid for minimum three years; the widely applied in administrative work principle of tacit refusal should be replaced by the principle of tacit approval.

Efforts to facilitate the access of SMEs to credits resulted in intentions to set up two credit risk guarantee funds. The first is national, and the second - municipal, on a resolution by the Sofia Municipal Council. Unlike the already operating fund set up by MLSP, these will be business-oriented and will not perform social functions.

Encouragement Bank developed together with the Agency for Small and Medium-sized Enterprises a **project for a National Guarantee Fund for SMEs**, which was submitted to the Ministry of Finance in May.¹⁰ The Fund should start its activities in the beginning of 2003 with a capital of BGL 10 m. provided from the national budget. It will guarantee up to 50 percent of the principal of loans granted by commercial banks to small or medium-sized enterprises, but not more than BGL 200 000. It should serve enterprises that satisfy SME criteria, have at least two years of experience in the sector and have been private in terms of the form of capital ownership during that period. Applications of production companies, high-tech small and medium-sized companies, export-oriented companies will be considered with priority. Companies engaged in tourism or transport, companies with a scope of business related to environment protection, healthcare entities with the status of small and medium-sized enterprises, R&D companies will also have priority.

In fulfilment of Art. 10, Para 1, item 2 of PPCA, which provides that 10 percent of the proceeds from municipal privatization should be deposited in a **municipal guarantee fund for SMEs**, the Sofia Municipality announced its intention to set up such fund¹¹. According to the adopted Rules on the Organization and Activities of the Special Municipal Privatization Fund of the Sofia Municipal Council (SMC), in Accordance with Art. 10 of PPCA, Appendix No. 1 to Resolution No. 20, Minutes No. 38/20 May 2002, § 2 of the Transitional and Final Provisions provides that until a municipal guarantee fund for SMEs is set up, the funds to the amount of 10 percent of the cash proceeds from municipal privatization shall be deposited in the special municipal privatization fund. According to the 2002 Work Plan of the Sofia Municipal Privatization Agency (Sofia MPA), proceeds from the privatization of municipal property are

⁹ ASME site, <http://www.asme.bg/bg/regimes/default.htm>

¹⁰ Media information, <http://www.dnevnik.bg/show/Default.asp?storyid=46094>,
<http://www.capital.bg/article.php?broi=2002>

¹¹ Media information, Dnevnik daily, 17 June 2002, <http://www.dnevnik.bg/show/Default.asp?storyid=49212>

estimated at BGL 9 070 000, out of which BGL 8 210 000 will be deposited in the special municipal privatization fund, including the amount for the municipal guarantee fund for SMEs.¹² According to a resolution of SMC, the documents for registration and management of the fund must be drawn up by the Mayor of Sofia by 15 November 2002. The fund is expected to start operations in the beginning of next year.

The example of Sofia Municipality should be also followed by other municipalities that have property subject to privatization. Thus some of the problems associated with the difficult access of SMEs to financing could be settled at municipal level. In addition to the existing guarantee fund of MLSP which has mainly social functions, to the future national guarantee fund and municipal guarantee funds, which will have limited resources altogether, the branch associations should also make efforts to set up branch guarantee funds. These could help to mitigate the financial problems of the companies within individual industrial sectors, by making maximum use of the knowledge of their specific scope of business.

The steps taken to reduce administrative barriers and to facilitate the access to loans are undoubtedly important for the SME sector. Adopted resolutions and declared intentions in the above fields are expected to have positive effect on the conditions for doing business, which, however, will be felt in the future as the specific actions on the implementation of these resolutions and intentions still lie ahead and the positive effect of these actions will be felt not until some time (at least 6 months). Nevertheless, they are a good manifestation of the efforts to improve the conditions for development of SMEs and should serve as an example for specific actions along these lines at regional level.

It should also be noted that despite the launched discussions on the government tax policy till 2005, at this point there are not **any particular intentions to implement a tax policy targeted at SME sector support**, while it is this field that generates most problems for the small business. The subject is discussed in detail in the section on tax policy.

In June the Agency for Small and Medium-sized Enterprises organized a **coordinating meeting of donors, government administration and non-government organizations supporting SMEs**. A draft of major priorities in attracting external assistance for the development of SMEs in Bulgaria, divided by specific areas of influence was presented at the meeting. The purpose of this meeting was to achieve **better awareness and efficient coordination of actions in support of SMEs** and it provided a forum for critical analysis of proposed priorities, as well as for making proposals and additions. The initiative was undoubtedly important and useful, because in an environment of budget restrictions it is of primary importance **to make optimum use of available resources** - to avoid duplication of activities and to direct financing to solving the most important problems the SME sector faces.

Another event in this period is also worth mentioning in an analytical perspective - the **Report on SMEs in Bulgaria** was published. This is the third report on SMEs in Bulgaria. Statistical data used are for the year 2000. Together, the three consecutive reports cover statistical data for a 5-year period - 1996-2000 and allow following certain trends in the development of SMEs. Given the permanent shortage of representative information about the SME sector in Bulgaria to allow adequate analysis, presented data, though a little out-dated, enable comparison and certain conclusions about the state of the sector. Emphasis is now on: SME competitiveness,

¹² SofiaMPA data, <http://www.sofiampa.com/priloj.html>

SMEs in the information age, the role of SMEs as suppliers/sub-contractors for attracting foreign direct investments to Bulgaria, industrial groups (clusters). Similar to the previous two reports, analysis was made of: the importance of SMEs for the national economy, the macroeconomic environment, the regional differences of SMEs according to their location in the various planning regions, the legal framework and government policy for development of SMEs, the financing conditions and lending schemes, the role of SMEs in the process of EU integration, the organizations supporting SMEs. Finally, conclusions about the state of each analyzed field are made, together with recommendations for specific actions for improvement.

Foreign Economic Relations

The relatively slow pace of the world economy recovery has not yet started to cause consumer demand growth and does not create adequately favorable conditions for Bulgarian exports growth. The European Commission Quarterly Report on the EU Economy in the Second Quarter¹³ foresees a growth of 0.6 to 1 percent during the second and third quarters of the year, and this does not give grounds to expect substantial increase of consumer demand on one of our main foreign markets. In the period April – June the country's exports amounted to USD 1,254.5 million, which is an increase by 4.5 percent compared to the first quarter of the year and by 1.7 percent compared to the same period of 2001. In general, however, the exports in this half of the year amounted to USD 2,454.4 million and were by 2.4 percent less than the value of the exports in the same half of 2001. The monthly statistics show **an exports level maintained at approximately USD 410–420 million in the last five months (from February to June)**, which indicates preserved stable position of the Bulgarian export products on the international markets.

In terms of **export commodities composition** the prime and raw materials now exceed 41 percent of the total exports, and their value in the second quarter increased by 8 percent compared to the first quarter of the year. This is the result of improved international markets situation and increased prices of products that are principal in Bulgarian exports, such as steel, copper, carbamid. Considerable is the increase (by approximately 50 percent) of timber export. The growth of investment goods continues to increase and accounts now for 13.3 percent of the total exports, and in the second quarter it increased by 10.3 percent compared to the first quarter. A 7.6 percent increase is observed in energy resources, too. Only with consumer goods there was a decrease of exports by 2.1 percent in the second quarter of 2002 compared to the first quarter. This decrease is almost completely due to the lower export of clothes and footwear, which account for 60 percent in this export group. Given the narrow domestic market and the lack of marketing strategies and own marketing channels, sub-contracted work with customer's materials (processing agreements) continues to be viewed as a profitable strategy and an opportunity for production capacity utilization, achieving economies of scale and meeting the standards and quality requirements of the demanding international markets, which offer well-established products of trade marks. In the period under review there was a considerable growth in the group of foods (over 15 percent) and furniture and household appliances (over 22 percent).

In terms of **the geographic structure** of exports the EU share continues to grow (approximately 57 percent), although in terms of its value there was a slight decrease of about 0.6 percent compared to the period January - June 2001. Given the extremely small GDP growth in the European countries and the decreased imports (including in the EU-domestic trade) the achieved exports volume of USD 1393.1 million in the first half of 2002 may be considered a success. An important (and also fast growing) market for the Bulgarian export commodities remains Turkey, the export to which is increased by 22.5 percent compared to the first half of 2001 reaching USD 244.4 million or approximately 10 percent of Bulgaria's total

¹³ http://europa.eu.int/comm/economy_finance/publications/quarterly_report_on_the_euro_area_en.htm

exports. A positive trend that may be indicated is also the growth of export to CEFTA countries (by 6.2 percent for the first half of 2002 compared to the first half of 2001), hence the growth of this market from 5 to 5.4 percent of Bulgaria's total exports. Nevertheless, in terms of its value the export for the CEFTA countries remains relatively limited (USD 133.4 million).

In the second quarter of 2002 imports (CIF) increased by 17.3 percent compared to the first quarter and amounted to USD 1,840.4 million. Compared to the second quarter of 2001 the increase is only 0.6 percent, and for the half of the year there is even a decrease in the imports value by 1.5 percent compared to the same period of last year. The biggest increase in imports in the second quarter is with investment goods (by 28.1 percent) and prime and raw materials (by 18.8 percent). This is an indication of intensified economic activities, particularly given the fact that machinery, equipment and spare parts account for about 70 percent of the imported items in this group, while the supply of transport vehicles continues to hold a relatively unchanged level. The consumer goods import continues to grow (by 12.6 percent), due to which Bulgarian companies state the imports competition as one of the major factors causing difficulties to their successful activities. Enhanced integration with the EU is clearly seen in the geographic structure of imports – while in the period January – June 2001 the import from the EU was 48.8 percent, in the same period of 2002 it was already 51.3 percent of the total imports, reaching 55.6 percent already in June. Thus Russia's share in imports dropped already to 18.7 percent, and that of CEFTA countries - to 7 percent. The biggest increase occurred in the import from Turkey - 42.6 percent, and EU – 3.6 percent, and the biggest decrease – Russia (by 6.4 percent) and CEFTA (12.8 percent).

The trade balance deficit continues to grow, reaching USD -954.8 million in this half of the year (calculated on the basis of FOB export and CIF import). In the second quarter of 2002 the negative trade balance increased by 58.8 percent compared to the first quarter, but it decreased by 1.6 percent compared to the second quarter of 2001. The increase for the first six months of this year is only 1 percent compared to the first half of 2001. Over 60 percent of this negative balance occurred in the investment goods and it may be assumed to be a positive phenomenon if the fact, that transport vehicles account for a significant part of this import, is disregarded. The considerable improvement of the current account balance in the second quarter is due to the positive balance in services providing amounting to USD 171 million as a result of the doubled revenues in tourism. Since the demand in the West European countries will grow at a relatively slow pace, the export cannot be expected to increase substantially. On the other hand, the effort for attracting more foreign investments results in imports increase. If the increased domestic demand for imported consumer goods is added to the above, the further deterioration of the trade balance is inevitable.

Foreign investments

Against the background of the 2-year lasting world trend of delaying the investment processes pace, which is the result of the economy decline cycle, the limited inflow of direct foreign investments to Bulgaria since the beginning of 2002 seems logical. The observed decline from the beginning of the year, however, is due to domestic reasons. Given the unstable world economy and international financial markets, the investors are hot hasty to enter the slightly known and not well enough regulated Bulgarian market with its financial brokerage system, which operates on a relatively small scale. The investments attracted in the second quarter amount to USD 112.6 million and are close to the adjusted amount of investments in the first quarter - USD 116.8 million. The total investments into the

country during the first half of the year were USD 229.4 million, which is USD 150 million less than the investments in the same period of 2001. If the proceeds from the sale of the second GSM-operator license, amounting to USD 135 million, are deducted, the difference becomes minimal - USD 15 million. The second quarter of 2002 witnessed for the first time such a large amount of reinvested profit – USD 14.5 million, which accounts for approximately 13 percent of total amount of investments.

The study conducted by the Vienna Institute for International Economic Studies¹⁴ shows that the inflow of foreign investments into the transition countries in 2002 will be considerably smaller than in 2001. The investments were twice smaller for the first three months of the year only. In the case of Bulgaria the general reasons (declining growth of world economy and financial markets problems) are complemented by the delay of the expected large privatization transactions. The trend of attracting investors mainly in the labor-intensive sectors of the light industry is still in place due to the cheap labor. The estimate of the Vienna Institute is for USD 600 million of foreign investments in Bulgaria for the whole year 2002, which is a completely attainable level, however, it is only half of what the government is expecting to get. Given the fact that the funds under some of the already concluded privatization transactions will be paid in the second half of the year, it may be assumed that by the end of the year the foreign investments amount will reach USD 900–1000 million.

¹⁴ <http://www.wiiw.ac.at/news.html>

Government Policy

The government policy in the energy sector found its expression most of all in the new Energy Strategy of Bulgaria, which was adopted by the Council of Ministers in April 2002. The Strategy sets out the main objectives of the energy sector policy and specifies the tools for their accomplishment. It ensures a larger extent of transparency in the government activities and provides the potential investors with better candidness as to the business environment in the country.

The Strategy sets out in an objective and justified manner the most general long-term lines of development in the energy sector, taking as a premise and starting point the current situation in the sector and the trends manifested in the recent years, as well as the requirements relating to Bulgaria's accession with the European Union. The Strategy includes also a more specific plan for the period 2002–2005 and states the estimated benefits from the implementation of this plan, which will be used for comparison of the expectations and the actual facts, and will be the benchmark for potential adjustments of the government policy.

The major objective of the Strategy is to ensure efficient and reliable energy supply consistent with the environmental protection. A positive fact is that the energy sector development is considered not as such per se, but in the light of its interaction with the other economic sectors and its importance to the quality of life of the population.

The Strategy specifies also **tools** that will be employed for achieving this objective. They involve: organizational restructuring of the market, clear-cut defining of the functions of various institutions, liberalization, privatization, legislative amendments, changes in pricing policy and tariff re-balancing, fostering energy efficiency, effective social protection and positioning Bulgaria as a transit corridor of energy flows and as a regional energy center. What is notable is that the role of the Ministry of Energy and Energy Resources (MEER) is limited to creating the conditions for this sector's development. It is intended for the regulatory functions to be transferred completely to the State Energy Regulatory Commission (SERC), and the assessment of the market and its prospects to be done by the investors themselves, and not by the MEER¹⁵. This will prevent the conflict of interests between the state's functions for establishing the legal framework, the regulation and control over the companies in the sector, and exercising of its rights as an owner of most of the energy companies. The ultimate result will be a good environment for competition and for successful entry of the private initiative in the energy market in the country.

The Strategy provides for gradual, and not radical, implementation of the reforms, enabling all actors – energy companies, users and institutions – to adapt to the new conditions more easily. The smooth transition from a government administered and strongly monopolized to a regulated and partly liberalized environment in this sector is of significant importance to Bulgaria due to the lack of experience among the different actors. On the other hand, it should

¹⁵ For this reason the Strategy does not contain estimates about the annual consumption and production, as the practice used to be with the strategic documents that preceded it.

be kept in mind that in the last three years no considerable progress was made towards establishing of market attitudes among energy companies, users and institutions, and this delay needs to be overcome relatively fast, in order for the reforms to bring about actual benefits for both the companies and the society. The foreseen reforms have to facilitate Bulgaria's integration with the European Union; therefore the Strategy stipulates that the pace of changes in Bulgaria has to be faster than that in the EU member-states.

The main guidelines for the **gas supply sub-sector** stipulated by the Strategy include: gradual market liberalization, increase of gas consumption among households, expansion of the possibilities for natural gas transit from Russia to Bulgaria's neighboring countries, involvement in the international natural gas pipelines routes from the Caspian Sea region towards Europe, and development of the local natural gas deposits. The successful implementation of these intentions will result in improved conditions for natural gas deliveries to the large industrial users, will ensure households' access to more efficient and environment friendly energy resources, will help reduce the dependence on the energy supply on a single country and will facilitate Bulgaria in establishing itself as an energy distribution center.

With a view to the critical condition of the **heat supply sub-sector** the Strategy defines as priority objectives the renovation of the district heating network, the development of the habit of managing the heat energy consumption, the implementation of corporate governance and the fund-raising for these activities. The implementation of the above objectives will alleviate the financial situation of heating companies because it will limit both their technological and commercial losses. A positive effect will be generated for consumers, too, because they will be able to manage their consumption and therefore their costs, and this is a prerequisite for them to pay their bills regularly to the heating companies.

The efforts of the governmental institutions in the **coal mining sub-sector** will attach priority to raising financial means (from the budget and from private investors) for the development of the vital companies, improving the companies' efficiency with a view to ensuring competitive deliveries to industrial consumers of coal, and the implementation of measures for environmental protection. A positive indication is the fact that the restructuring impact on employment is taken into account and the application of alternative employment measures is provided for. This is of crucial importance, given the fact that according to the European Union surveys coal-mining industry workers are among those who face the hardest difficulties in labor market adaptation.

Concerning the **electricity sub-sector** the Strategy outlines the framework for the market relations restructuring, the gradual transition from the single buyer model to a regulated third party access to the network and the striking of a better balance between the prices for household and for industrial consumers. These more specific responsibilities of the state authorities create more favorable conditions for the investors in all sectors of economy, because they minimize the risk of uncertainty and unexpected decisions. This is of substantial importance for attracting stable investors, especially with a view to the forthcoming privatization of the electricity distribution companies, which according to the Strategy has to be completed by the end of 2003.

The Strategy does not give a clear answer to the question about the Bulgarian government's position on closing down of the first four units of Kozloduy Nuclear Power Plant (NPP). It foresees consultations with the European Union on this issue, where the Bulgarian stand will

be based on the analysis of the safety, economic and social aspects and environmental protection impacts¹⁶ of a decision to the above mentioned effect. The discussion on the matter, which took place after the adoption of the Strategy, was prevailed by the opinion that a high standard of technical safety had been achieved in Kozloduy NPP and this, in combination with the economic and social aspects of the issue gives sufficient grounds for reconsidering the requests for pre-term closing of the small units.

Bulgaria's Energy Strategy was discussed also in the National Assembly and was approved by it in mid-July 2002.

During the quarter under review **the Government's effort for withdrawal of the state from ownership in the energy sector became more active.** The Privatization Agency (PA) launched a program for the sale of 21 small hydro power plants and 6 cascades of hydro power plants. By means of bidding procedures in this period the buyers were selected for 6 of these plants and 1 of the cascades with a total installed capacity of approximately 34 MW. In case the Supervisory Board of the PA approves of the transactions, then the cash proceeds will be over BGL 24 million, while the estimated proceeds from the energy companies' privatization for 2002 are BGL 50 million.

Certain progress has also been made regarding the projects for the thermal power plants (TPP) of the Maritsa Iztok complex. Through loans from four banks funding was provided for approximately 50 percent of the project of Entergy and the National Electric Company (NEK) for the refurbishment of Maritsa Iztok-3 TPP. In the beginning of July SERC granted permission to AES for the construction of a new facility on the production ground of Maritsa Iztok-1 TPP, and the construction work is expected to start in April 2003. The benefits from the implementation of this project will be multifold: employment will be created in the region, the production capacity of Maritsa Iztok mines will be better used, the regularity of electric power distribution in the country will be ensured, there will be production prerequisites for preserving Bulgaria's leading role as a net exporter of electric power, there will be a transfer of know-how and leading experience in the sector. Last but not least, it should be noted that these projects will produce the effect of increasing investors' trust in the business environment in Bulgaria.

In the second quarter of 2002 SERC **adopted a preliminary plan for increasing the prices of electric power for households**¹⁷ over the next three years. The intention is in 2002 the household prices to be increased by 20 percent, in 2003 – by another 15 percent, and in 2004 – by another 10 percent. The price increase is required in order to strike an improved tariffs balance between the household and industrial users and to introduce a normal market pricing practice, where the users, for which the costs are smaller and the delivered quantities are bigger, will pay at lower unit rates. Adoption of the preliminary plan is a positive step because it provides potential investors both in electric power companies and large industrial consumers with a better idea about the measures to be applied.

¹⁶ The nuclear power industry is considered to be environmentally friendly because the environment is not polluted in the course of a normal production process.

¹⁷ Decision No. C-028 OF 28 June 2002. of SERC, www.dker.bg

Energy Prices

The legal and market conditions for decreasing the prices of energy resources in the real sector in the second quarter of 2002 brought about favorable consequences for the business in Bulgaria. They have an indirect effect also on the households, but this effect is neutralized by the higher prices of heat and electricity for households, which once again raises concerns among the population about the affordability of the price reform.

In compliance with the plan adopted by SERC at the beginning of July 2002 **new prices of electricity and heat for households entered into force, the average increase being 20 percent and 11.4 percent, respectively.** A two-step scheme was introduced, where the tariffs prior to their increase would be applicable to 75 KWh of electricity consumed in daytime throughout the whole year, and in winter the following are added to it: 50 KWh of electricity consumed during the night for dwellings without district heating, and 250 KWh for the other dwellings. Such a scheme is in contradiction with the market economy logic according to which larger consumers pay at lower unit prices. The purpose of the scheme, however, is not to encourage the consumption of larger quantities of electricity, but to make households use electricity more wisely and cautiously, thus exercising control over their consumption and costs. For this scheme to be efficient a large-scale awareness campaign needs to be conducted among the population informing it about the possible energy efficiency measures.

The increase of electricity prices for households **accounts for 1.5 percent increase of the inflation in July compared to June.** The inflation pressure in July was neutralized to a large extent by the fact that usually in summer expenses for other products, such as fruits and vegetables, are smaller, and also by the impact of the lower US dollar exchange rates on oil products. On the other hand, the introduction of lower tariffs for 50 KWh nighttime electricity for approximately 3.5 million district-heating users in the beginning of the heating season will have an anti-inflation effect.

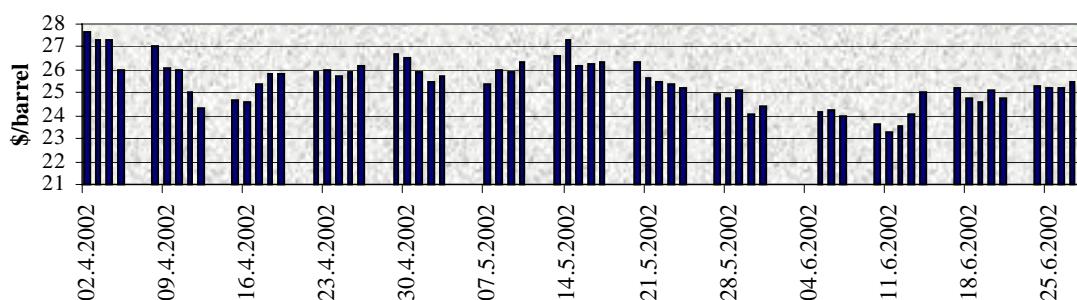
The new electricity prices will not affect the business, and therefore, there will not be indirect inflation effect. Moreover, **in mid-term industrial consumers will receive not only regulatory, but also market opportunities for more favorable price conditions related to electricity supply.** The first manifestation of these opportunities may be considered to be the NEK's proposal for lower tariffs for industrial consumers on weekends, which is about to be considered by SERC. Attaining of better pricing conditions is of significant importance for improving the competitiveness of the Bulgarian economy, taking into account the fact that Bulgaria's GDP is 10 times more energy intensive than that of the EU member-states and twice more energy intensive than the GDP of the other Central and East European countries, without having considerable energy resources of its own. The companies' better competitiveness in its turn supports economic growth and hence, the opening of new jobs, too. Further on, the lower production costs will result also in decrease of domestic market prices of those products and services, for which strong market competition is in place.

In the period under review the crude oil price quotations were unstable and fluctuated between USD 23 and USD 28 per barrel. Their dynamics was dictated by the course of the conflict in the Near East, the oil reserves in the USA, the introduced by Iraq one-month embargo on oil export, the problems with the implementation of the UN "oil for food" program for Iraq, the decisions made by the major players – OPEC, Russia and Norway – regarding oil production

and export volumes, and the collapse of the shares on the world capital markets. In general, however, **the oil prices in the second quarter were lower than those in the first quarter.**

Figure 7.

Brent Crude Oil Price Dynamics (International Oil Exchange, London)



Source: International Oil Exchange, www.ipe.uk.com

The lower oil prices are beneficial for the highly energy-intensive Bulgarian economy, because the costs for import of oil products are directly dependent on the development of the international markets. In the quarter under review the effect of the lower prices was further fostered by the lower dollar rates. As a result of these trends the production costs of the Bulgarian refineries decreased, which effect was gradually passed on also to the users by means of decreasing the oil products prices on the domestic market.

The lower oil prices and dollar rates are favorable for both natural gas supply and consumption in Bulgaria. Bulgargas, which imports natural gas at prices linked to the oil products quotations on the international markets, had its costs per import unit decreased, and this helped the company in the settlement of its liabilities to the budget. The new price situation with natural gas delivery allows for reduction of the prices, at which the monopolist sells natural gas to large consumers. The slight reduction of these prices by 3 percent since 1 July 2002 may be considered as the first concrete expression of this opportunity. Another more considerable price cut is expected this autumn, because at present Bulgargas is still selling the quantities bought at a higher international oil price and higher dollar rate. Such price changes allow the companies in the fertilizers, glass, oil, cement and ceramics industries to compete more successfully on the international markets. A positive effect will occur also for the district heating companies, but it is limited by the fact that their production is at minimum levels in the spring and summer.

TRANSPORT

In the second quarter of 2002 the transport sector had no developments toward substantial improvement of both its efficiency and the benefits it produces through its services for its industrial and commercial clients. However, it should be noted that a number of actions were initiated, which will have a positive impact on the business in Bulgaria in mid-term.

Examples of such actions are the undertaken **preliminary measures for improvement of the Sofia Airport infrastructure and the construction of the second bridge over the Danube at Vidin – Calafat**. The Ministry of Transport and Communications (MTC) announced a bidding procedure for a main contractor of the project for the construction of a new passenger terminal. Further, it conducted a bidding procedure for the construction of a new runway at Sofia Airport. The contracts with the successful bidders are expected to be signed in the third quarter of the year. Also, the second stage of the competition for selecting an international consultant for engineering and management of the Danube River Bridge Project started; the expectation is that the successful candidate from among the seven short-listed candidates will be selected by the end of September 2002.

The implementation of the above mentioned large-scale projects would bring about undoubted benefits for Bulgaria. The new bridge over the Danube will ensure a new road and railway link between Bulgaria and Central and Western Europe, the latter being the main destinations of Bulgarian exports. The upgraded infrastructure of Sofia Airport will be an opportunity for Bulgaria to strengthen its position as a transport crossroad and to attract more passengers and cargoes.

Another component of the government policy, which will have a significant effect in the future, are **the amendments to the Act on Marine Areas, Inland Water Routes and Ports**, which are being drafted. Their main objective is to assign to the private sector a stronger role in the performance of port operations by granting concessions for the infrastructure facilities and liberalization of certain activities. The probable consequences of these measures include better quality and variety of the services offered. In order to protect consumers of monopoly port services, which will be offered by the new private operators, against unfair price increase, the amendments will provide for regulation of the price ceilings for ship handling. This approach is also a prerequisite for attracting cargo and passenger ships to the Bulgarian ports, because carriers will be provided with statutory guarantees that their interests will be protected. The regulation of the price ceilings will also provide incentives for the port operators to improve their efficiency and, by reducing their costs, to generate higher profit.

The amendments to the Act on Marine Areas, Inland Water Routes and Ports are intended to give an answer to the question about the future of 23 private ports, which carry out loading and unloading, in spite of the fact that pursuant to the law only the public transport ports are entitled to perform such an activity¹⁸. The ports concerned used to belong to former non-transport state-owned companies and were passed on into the hands of the private sector through the privatization of such companies. The debate as to whether they should be transferred back to

¹⁸ Public transport ports are actually only the ports, which are public state property and are listed under Article 103, paragraph 2 of the Marine Areas, Inland Water Routes and Ports Act.

the state, or they should be granted the status of ports, which can perform loading and unloading operations, provided they meet certain technical requirements, is awaiting its final resolution.

During the quarter under review **no considerable progress was made in the privatization of assets in the Transport sector, which still belong to the state.** The implementation of the program for granting concessions on airports and ports, which was announced in the preceding quarter of the year, is still in delay, and this may lessen the investors' interest in it. No license was granted to a private operator in the railway transport, either. An encouraging indication that should be pointed out is the privatization of Port Fleet 99-Varna, as a result of which the performance of activities relating to providing services to vessels¹⁹ was transferred into private hands as a good opportunity for improvement of the technical condition of the facilities, and hence the quality of the offered services.

¹⁹ Port Fleet 99 Varna deals with maneuvering, berthing and unberthing of vessels, booking and loading-unloading operations by a pontoon crane at Varna ports.

HIGH TECHNOLOGY AND COMMUNICATIONS

To a certain extent the trend from the beginning of the year continued also through the second quarter of 2002; this is a trend of revitalization of the sector, a larger number of positive (most of them beneficial) events, meetings, discussions, and regretfully, not quite that tangible results. The points here below list the most significant of the above:

- Adoption of the Updated Telecommunications Sector Policy of the Republic of Bulgaria
- Privatization of the Bulgarian Telecommunications Company (BTC)
- Drafting of a Strategy for E-Government
- Forum of the Bulgarian Association of Software Companies
- Purchase of 30,000 licenses for the use of MS Windows XP and Office XP by the government administration
- Project for setting up high-tech incubators under the PHARE Program

Updated Telecommunications Sector Policy of the Republic of Bulgaria

The updating of the Telecommunications Sector Policy was strongly needed given the rapid development of the situation in this sector – Bulgaria's new commitments related to the negotiations with the EU on Chapter 19 Telecommunications, the new strategy for privatization of the BTC, expansion of the telecommunications market in the country, (entry of new significant participants such as Globul) and last but not least, the forthcoming liberalization of the telecommunications market.

A positive feature of this new document adopted by the Council of Ministers is the provision for concrete measures to be undertaken, and the deadlines for their implementation. The Updated Strategy is characterized also by its better structure and clarity regarding the tasks that are to be fulfilled.

In spite of the positive features of the Strategy, still the most important part will be its implementation and the meeting of the set deadlines. For an adequate response to the future challenges that are to come after the telecommunications market liberalization after the end of 2002, a good preparation and planning will be required, and the Updated Strategy sets only their beginning.

BTC Privatization

Undoubtedly, one of the most important, and naturally most widely commented events in the second quarter of 2002 was the progress of the BTC preparation for privatization. **The strategy for the Telecom privatization was adopted by the Parliament at the end of March, and on 4th April the Privatization Agency opened the procedure.**

A delay in the privatization process occurred still at the very beginning – the deadline for completion of the first stage of submission of indicative tenders (27th May) was extended until 10th June. Within the stipulated term three candidates submitted indicative tenders, namely:

- AIG – CET Capital Management
- Viva Ventures Holding GmbH

- Consortium of Koc Bilgi Grubu İletişim Ve Teknoloji Hizmetleri A.S., Turkey and Turk Telekomunikasyon A.S.

All the three candidates have declared in their tenders their interest in acquiring a third GSM-operator license, however more detailed intention and price will be submitted with the final tenders.

There are no strategic investors among the companies that expressed interest in the national Telecom; this is an indication that if this process comes to finalization of the transaction, this will not be the last change of the ownership over the BTC in the relatively near future. On the other hand, the fact that all the three candidates definitely occupy a good position on the world markets and a good reputation is definitely positive.

The fact that there are three indicative tenders for the BTC which come from world-famous companies, if not anything else, at least arouses expectations for real competition and coming to a successful finalization of the long-awaited transaction.

Preparation of a Strategy for Electronic Government

The developments with regards to putting together a Strategy for Electronic Government in Bulgaria are interesting. The preparation of such a Strategy is among the most immediate tasks of the Coordination Center for Information, Communication and Management Technologies, which ensures cooperation among the private sector, NGOs and public administration. In this connection in the beginning of June a round-table discussion was held on the topic: Public Agreement for Successful Setting up of E-Government in Bulgaria. As a result of the discussion the initial version of the strategy for E-government was revised in compliance with the suggestions placed by the participants. The work plan of the Coordination Center for Information, Communication and Management Technologies states that the Strategy should be ready by the end of the current year.

The Strategy should offer:

- A profound understanding of E-government, its main objectives, characteristics, specifics and risks in the course of its putting into practice;
- The key indicators for analysis and control of the E-government implementation;
- The most important elements of organization and management, the techniques, resources and funds for the success of the operation.

The main objective of the E-government is to provide quality, cost-effective and easily accessible public-administrative services to the citizens, public organizations and economic actors, thus accelerating the economic and social development of the Republic of Bulgaria.

The tasks, which the E-government has to resolve in the long-term, include creating a possibility for efficient communication of the government with the citizens and businesses by means of information technologies. A part of it covers the following:

- Reducing the time and funds required for servicing the citizens and businesses, and redirecting the administration resources towards expanding the scope and improvement of the quality of the services provided by the government;
- Optimization of the management and business processes in the government administration and establishing more flexible management systems;

- Achieving the maximum possible security and reliability of the basic information systems and infrastructures;
- Achieving the maximum possible level of independence of the E-government from concrete platforms, technologies, application packages and companies (in the users' perspective);
- Harmonization of the standards relating to the E-government with the ones applied in the European Union.

The development of the idea of establishing E-government in Bulgaria is a substantial step towards the expansion of the information society potential and for achieving the standards of developed countries. It is a positive development that in the E-government strategy preparation the support and assistance from all parties in the relations with the government administration is sought: businesses, non-for-profit sector, academic circles, and civil society.

Forum of the Bulgarian Association of Software Companies

One of the significant events, which attracted the attention of the ICT sector in the period under review, was the conference, organized by the Bulgarian Association of Software Companies (BASSCOM), and titled **“Bulgaria: a Booming Software Development Center”**.

The Conference was held on 19th and 20th June under the auspices of the Bulgarian Association for Information Technology (BAIT) and with the support of the ICT Development Agency with the Ministry of Transport and Communications.

The intention behind conducting the forum was to formulate a strategy for development of the software industry and to outline concrete actions for its putting into practice.

The Conference was wrapped up by adoption of a Charter for Co-operation for the Development of the Software Industry in Bulgaria, which expresses the common readiness for joint activities on the application of the strategy.

The bottom line of the conference, around which the representatives of the ICT business were united, was that the Bulgarian software industry is in position to be competitive in the world markets, and become the drive for growth of the Bulgarian economy by achieving an annual growth of 20 to 30 percent, thereby achieving an annual turnover of USD 1 to 2 billion by 2010.

A positive fact that deserves to be noted is that the conference gathered together representatives of business, branch organizations and not-for-profit organizations, academic circles and government administration, and was conducted in the spirit of cooperation and understanding among all parties involved.

The Deal with Microsoft

At the end of May the Minister of State Administration signed a contract with Microsoft for obtaining the license for the use of 30,000 packages of the localized product of Microsoft MS Windows XP and Office XP. These licenses are completely for the needs of the government, municipal and regional administrations. The amount that the Bulgarian state has to pay over a period of three years is USD 13.65 million (VAT excluded), and the payment will be effected in

several installments: USD 3.15 million this year, and USD 5.25 million per year over the two following years.

The transaction aroused strong interest, however, it was accepted with complete dissatisfaction by the actors in this business due to several main reasons, as follows:

- Evasion of the Public Procurement Act;
- Choice of a Microsoft product without assessing the potential alternatives based on the so-called open code, and without conducting a profound discussion with experts in the field;
- Unusually high price of the license (and small discount, respectively);
- Lack of transparency in the concluding of the transaction;
- Finalizing a transaction of such a large scale without making an analysis to establish how many of the computer systems in the government, municipal and regional administrations will be able to operate using the product – subject of the transaction.

The major advantage of this transaction according to the Minister himself is to take Bulgaria out of the negative list of countries with the strongest presence of software piracy.

It is a fact, however, that the decision for concluding the transaction without consulting the professionals in the sphere and without discussing it causes tension in the sector and provokes negative attitude towards the whole government administration and its activities.

Project for Setting up High-tech Incubators (under the PHARE Program)

No (in this case meaning negative) progress was observed during the second quarter with regards to the Project for setting up high-tech incubators under the PHARE. The delay in this case may prove out to be a less important problem than the “freezing” of the project by the European Commission. The possibility of the latter to happen is becoming more and more probable after the Delegation of the European Commission announced at the end of May that it discontinued the funding under the project of business incubators in regions with industrial decline due to warnings about lack of transparency in the preparation of the project. The fate of the project for high-tech incubators may be similar, and therefore the government administration, obviously, prefers for the time being to wait until the Commission passes a resolution regarding the other project mentioned above.

Any lagging behind and delay of a project of this type has a negative impact on the development of small and medium-sized business in Bulgaria, because it deprives the entrepreneurs of a number of opportunities, which would occur in case of successful progress of the project.

Revenues from Tourism

According to data from the NSI in the period January – June 2002 Bulgaria was visited for by 1 126 889 foreign tourists, which is by 6.36 more than the figure for the same period of last year. In May only the number of tourists was 15 percent higher than in May of last year, and in June – 11 percent higher. The increase is due most of all to tourists from EU and mainly from Germany – their number increased by 30 percent in the first half of the year (the expectation is that their number will be over 0.5 million for the whole year). The number of British tourists, as well as of visitors from the Scandinavian countries, has substantially increased. The number of Russian and Ukrainian tourists decreased by approximately 30 percent, however this decrease is smaller than that estimated by the Ministry of Economy and BATA.

On the other hand **the number of Bulgarians traveling abroad is increasing**: for the first six months of the year this increase was by 24.75 percent compared to the same period of last year. Highest was the increase of those visiting Turkey – by 61.88 percent. The flow to Greece is increasing, too, although not that substantially (by 13.2 percent).

According to data from the BNB **revenues** from tourism in the second quarter of 2002 reached USD 331.9 million – compared to the first quarter of 2002 (USD 152.6 million) the revenues have increased twice. Compared to the second quarter of last year (USD 303.8 million) the increase is by USD 28 million. Bulgarians' **spending** abroad in the period April – June 2002 was USD 143.5 million, which is a little higher than in the same period of last year (USD 137.2 million).

The net revenue from tourism in the second quarter of last year was USD 166.6 million, while in the current year this revenue was USD 188.4 million, which is a USD 22-million increase. **As a total for the first half of 2002 the revenue from tourism** reached USD 484.5 million compared to USD 460.1 million in the first half of last year. **Bulgarians' spending abroad in the first half** of the current year was USD 263.8 million, while in the same period of last year it was USD 237.1 million. **For the first 6 months of 2002 the net revenue from tourism** was **USD 220.7 million**, while last year it was USD 223 million, i.e. there is a slight decline in the net revenue, which is due mostly to the increased expenditures of Bulgarians abroad spent in the first quarter of 2002.

According to representatives of the branch associations the good summer tourist season will result in increasing the revenues from tourism by 10–15 percent compared to last year (the revenues from tourism in 2001 were USD 1.250 billion). However, since the pace of increase of Bulgarians traveling abroad outstrips the estimated increased number of foreign visitors to Bulgaria, **the net revenue from tourism on the balance of payments** of the country will most probably be a little higher than last year – higher by 3 to 4 percent.

External Environment for Tourism Development

The current year seems to be unfavorable for the tourist sector worldwide. The 11th September 2001 attacks caused a 7 percent decrease of the tourist services demand in 2001-2002 and the

loss of approximately 10 million jobs in this sphere. The estimates are that there will be less tourists going to such traditional tourist destinations as Spain (by 12 percent), Italy, etc.

Against the background of the above-mentioned negative trends, the estimates for the summer tourist season in Bulgaria, announced in June, are optimistic – an increased number of tourists and revenues from tourism are expected. The competition of the Bulgarian tour operators comes mostly from Turkish companies (in the first five months of this year only Turkey was visited by 3.6 percent more tourists compared to the same period of last year, and Bulgarian tourists account to a large extent for this increase). There are good prospects for Croatia, which relies on its current year strategy of attracting tourists coming to the Adriatic Sea Coast by cars from the neighboring and other close countries.

Legislative Framework

The new **Tourism Act** was passed at first reading in the second quarter (May) and it will officially enter into effect on 1st October 2002. The main provisions in this Act are as follows:

- The hotel and catering licenses will be repealed (this provision enters into force as of the date of promulgation of the Act in the Official Gazette);
- The licenses for tour operator and tour agency activities will remain as a requirement (their term will become indefinite);
- The tourist associations will have the opportunity to be involved in license granting and categorization of tourist sites;
- Rules are introduced for the organization of group and individual tourist trips with a total price as valid in the EU;
- A new institution will be established: the Executive Agency for National Tourist Promotion and Information;
- Inter- departmental Council on Tourism is established;
- The idea for setting up a tourism-quality agency has been rejected – these functions will be performed by the Trade and Consumer Protection Commission;
- Detailed provision of the contractual relations between the tourist, and the tour operator or tourist agent.

The Problems in Tourism

The major problems that continued to impede the normal development of the sector (especially in the beginning of the high season) are as discussed below.

Construction in Progress

Works on renovation of the infrastructure of Slanchev Bryag – water and sewerage, and electric wiring - continued; the partial renovation of the infrastructure at Zlatni Pyassatsi also continued. Conducting of these works resulted in moving tourists to other resorts, penalties paid to tour operators, and risk of reconsidering the investments programs by some major tour operators. It is of utmost importance for Bulgaria to create the required conditions for expanding the high season – it might start, for example, on 1st May and finish at the end of October. This would mean the construction to be managed so as to finish on 30th April (with a mandatory suspension of the construction works in due time, otherwise there is a probable risk that some main tour operators, especially the German ones, would not offer in their brochures their Bulgarian destinations in May, which will result in about 10 percent decrease of the revenues).

The resolving of the above problems is to a considerable extent within the powers of the government – by means of imposing normal deadlines for construction permits issuance and a strict prohibition of construction after a certain date of the year.

Beach Concessions

A new set of regulations needs to be considered regarding the tenders for granting concessions on the beaches, alongside with a new methodology for setting the concession fees, as well as a categorization of the beaches needs to be developed and control to be strengthened. Most probably this will be done as early as next year.

Visas for Russian and Ukrainian Tourists

A drop down in the number of Russian, Ukrainian and Belarusian tourists is expected; some of the forecasts, for example for Albena resort, show a decline of the Russian tourists of up to 75 percent. The reason is the introduction of visa requirements for these tourists on 1st October 2001. Another reason is the distortion among Russian tour operators after their re-licensing. A solution to this problem is being actively sought: Bulgaria is prepared to open three new consular offices in Russia (consuls have already been appointed). The option for granting visas through digital channels will also be used.

Environment for Development

After the start of negotiations on the Agriculture Chapter, the preparation for accession with the EU and the need for harmonization of the legislation and procedures, the Ministry of Agriculture and Forestry (MAF) proceeded with the discussion of the opportunities for granting an export subsidy for a basket of 44 Bulgarian agricultural products in 2003. It is already known that wheat will be the first subsidized export product. It is of substantial importance on the basis of what principle the subsidies will be granted, namely: whether with a view to supporting the producers, most of whom are small with fragmented low-efficient production, or with a view to enhancing the development of a highly productive, market oriented agriculture. Subsidies will be granted for export of the surplus of agricultural produce, their purpose being to cover the gap between the domestic farm-gate prices and the export prices. Coverage of the subsidies for agriculture will increase every next year. Thus the Bulgarian policy in the field of agriculture is getting closer to the common agricultural policy of the EU.

The adopted amendments to the National Plan for Agriculture and Rural Development until 2006 allow for an increase of investments in agriculture under the SAPARD Program. The six new measures that will probably be accredited by the end of this year, and the other two measures that are being prepared for putting forward to the European Commission, are aimed at supporting the farmers in their activities for compliance with the European standards of food quality and safety, environment protection, and opening of new jobs. In this connection is also the decision made by the National Council for Food Safety with the Council of Ministers to approve the suggestions placed by the food-industry branch associations for introduction of "good production and sanitation practices" as work rules in the production of foods. These will be aimed at improving the control over quality, sanitation and technology for the production of foodstuff, thus safeguarding consumers' health. Their introduction is in compliance with the Foods Act and is particularly necessary after closing the chapter on free movement of goods. It is expected that the application of uniform veterinary and hygiene requirements will result in improved competitiveness of Bulgarian export products in EU member-states.

Further on, Ordinance No. 7 on the sanitation requirements to companies, which produce or trade in foods, and to the conditions for production and trade of quality and safe foods makes the production technology documentation a part of the internal controls system, and the responsibility for the products safety will be completely assumed by the producer. The above-mentioned Ordinance meets the principles of the new EU approach to ensuring foods quality and safety, where the policy (legislation) specifies only the objective that has to be achieved, while the producers develop their own procedures for achieving the required objective, namely foods safety to be guaranteed.

Related to the production conditions improvement and the application of the European standards is also the repealing by the Veterinary Committee of the European Commission of the prohibition, imposed in February 2000, on the export of fish and fish products from Bulgaria to the EU. Bulgaria developed and presented a plan for aquaculture monitoring, which ensures the control over the producers and traders of fish and fish products. Further on, another three companies obtain permission for export of dairy products to the EU, thus the total number of

companies – exporters from Bulgaria becomes 8. With the improvement of legislation, strengthening the control, strict compliance with the requirements to foods quality and safety it may be expected that there will be an improvement in the implementation of the quotas granted to Bulgaria for agricultural products import into the EU.

Current State of the Agricultural Sector

Although constantly decreasing, the share of GDP and GVA (approximately 11 percent and 10 percent respectively in the second quarter of 2002) remains relatively high. According to the statistics the number of the employed in agriculture (in registered economic units) in June was over 83,000, which is approximately 4 percent of all the employed in the country. MAF, however, estimates the total number of the employed in agriculture to be over 230,000, which is 8.7 of the active population of the country. The census of the agricultural farms planned for 2003 is expected to provide more complete information about the structure of the farms and the number of their employees. Agricultural produce comprises approximately 9 percent of the export volume and 6 percent of the import volume.

According to data from MAF the area of the arable land sown with wheat is by approximately 600,000,000 sq.m. larger than in 2001, that sown with barley – by 650,000,000 sq.m larger, that sown with sunflower – by approximately 300,000,000 sq.m larger. Only the areas sown with corn are smaller. Decrease is observed also of the areas sown with oil-bearing crops. Relatively high yield is expected, MAF forecast being for over 4 million tons of wheat. Compliance with the basic agro-technical requirements – quality seeds to be sowed, fertilizing and the necessary treatment to be carried out, is a prerequisite for good quality crops, which gives good prospects for export, given the decreased production of a number of countries – major suppliers on the international (the European market included) market. Nevertheless, the yield from the sown areas remains considerably lower than that in the European countries. The production is strongly dependent on the climatic conditions and every change in them has an impact on the produce quality and the expectations about the final result from the production and export. The Agriculture Fund is about to make a decision on subsidies for the storage of cereal crops, which will be in compliance with the drafted strategy for financial assistance to farmers and with the budget framework for the next year.

CAPITAL MARKET

The role of the capital market in Bulgaria's financial sector remains inconsiderable – as of the end of June 2002 the total market capitalization of the Bulgarian Stock Exchange – Sofia AD was a little over 4 percent of the updated GDP forecast (BNB and MoF estimates) for the year 2002. The underdevelopment of the capital market is explained both with the condition and prospects of the Bulgarian economy as a whole, and with the attractiveness (or absence) of financing projects through this alternative non-banking source. The capacity of the capital market as a source of funding, however, remains unknown or not preferred even in the cases when projects are available. As a result of these and other factors **liquidity remains low, the market does not encourage good corporate governance practices, and investment alternatives remain limited. Financial intermediation continues to be carried out predominantly through the banking sector.**

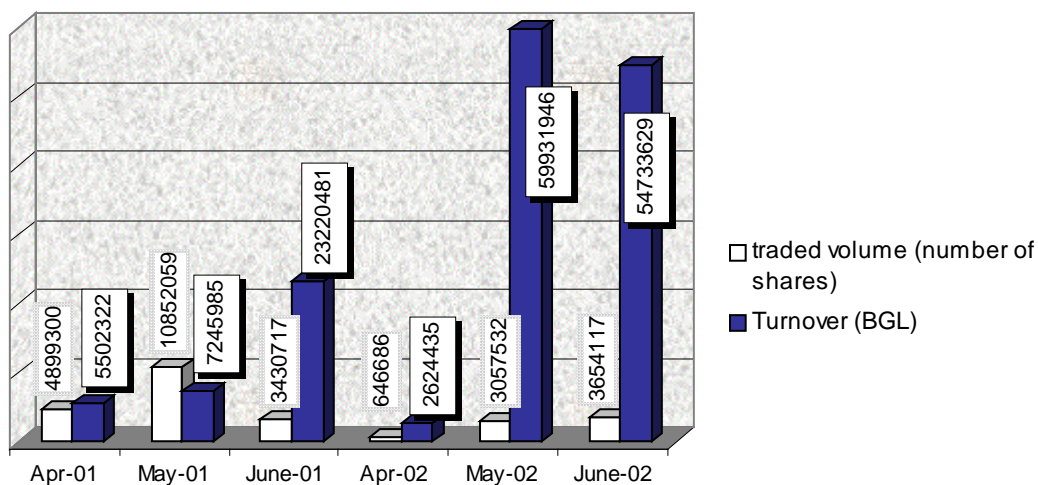
The Capital Market as per the Indicators of the Bulgarian Stock Exchange – Sofia JSC

As of 30th June the market capitalization according to data from the Stock Exchange was a total of BGL 1 289 279 147 (of which BGL 211 702 461 on the official markets), while as of the end of the first quarter of the year the market capitalization was a total of BGL 1 118 541 695 (of which BGL 201 979 442 on the official markets). Turnover in the second quarter of 2002 amounted to a total of BGL 117 290 010 and the traded shares were 7 358 335. SOFIX index as of 31st March was 120.56, while as of 30th June 2002 it was already 132.15.

Thus **the second quarter of the year witnessed positive development with some of the basic market indicators, which characterize the condition of the capital market in Bulgaria** (interpreted and measured traditionally by means of the indicators of the Bulgarian Stock Exchange – Sofia AD). In the second three months of the year the exchange turnover was higher than that in the first quarter, although with a smaller trade volume (it should be noted, however, that a considerable part of the turnover is due to the one-off transfer of the majority block of shares in one company, namely Sheraton Sofia AD). The market capitalization also marked an increase compared to the end of March, but given the low liquidity this fact cannot be firmly assessed. A confirmation of this conclusion is the fact that in terms of the trade turnover on the Bulgarian Stock Exchange AD the second quarter of 2002 had a positive development compared to the same period of last year, however the traded volumes for the periods and the market capitalization as of the end of the periods show a decline (See Figures 8 and 9). **The simultaneous decrease of the volumes and capitalization with an increase of the turnover is generally a manifestation of the trends to ownership consolidation and trade concentration over a smaller number of issues at the expense of declining liquidity of the larger part of the quoted securities.**

Figure 8.

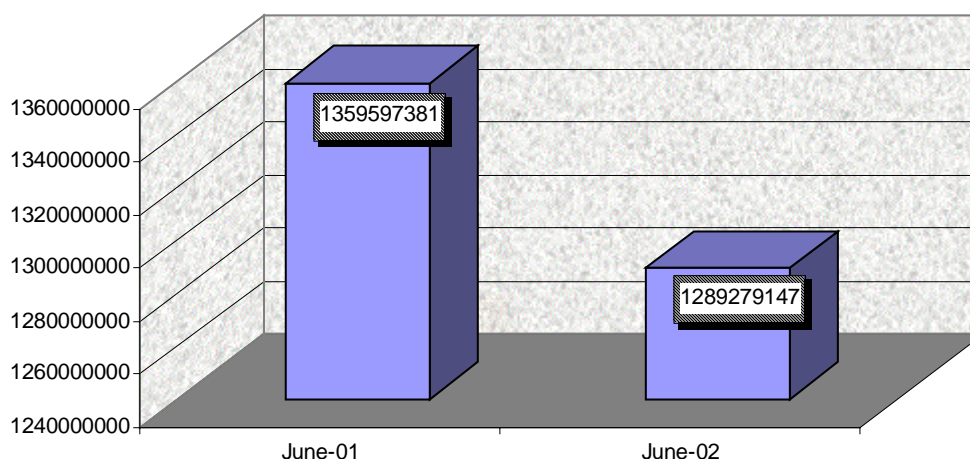
Trade at the Bulgarian Stock Exchange – Sofia AD (second quarter of 2001 and of 2002)



Source: data from the Bulgarian Stock Exchange – Sofia AD, monthly newsletters

Figure 9.

Bulgarian Stock Exchange - Sofia AD Market Capitalization as at End of Period



Source: data from the Bulgarian Stock Exchange – Sofia AD, monthly newsletters

Among the important second-quarter corporate news were the published annual financial statements of some of the most actively traded companies. The expectations for dividends and the forthcoming dates for the annual general meetings were the two major factors affecting the price fluctuations of shares of higher liquidity. Examples in this respect were the negative performance of Lukoil-Neftochim AD, while Sopharma AD had an improved financial performance compared to the previous year. The general meetings, however, did not in all cases meet the expectations of the portfolio investors – for example, in the case of Sopharma AD eventually no dividend distribution was voted for, while the dividends from Blagoevgrad – BT AD were higher than expected. It is namely the expectations about a dividend, but also the expectation regarding privatization of the remaining state-owned share or a potential liquidation, that resulted in a record increase of the price of Slanchev Bryag AD, together with

the more dynamic trading in shares of one of its major shareholders (and a company itself attractive), Slanchev Bryag Holding AD.

Nevertheless, **the relation between prices of the listed companies' shares and the publicly announced corporate news remains contradictory.** We may add to this problem also **the accounting and regulatory practices, and the corporate governance principles, which all need further elaboration.** The latter was illustrated by another two examples from the second quarter of the year. The first example is the above-mentioned transaction for the transfer of the majority share of Sheraton – Sofia AD. It caused the biggest turnover per one session registered on the Bulgarian Stock Exchange – Sofia AD since its licensing in 1997, but at the same time the suspicions that there might have been a violation of the legal requirements to the tender offers gave rise to conducting an inspection – which has not been completed yet – of the transaction by the State Securities Commission.

The second example is as follows: in May an announcement was made of the performance according to both the national and international accounting standards of another popular company, Bulgartabac Holding AD; there was a considerable discrepancy between the results in terms of the two above-mentioned sets of standards.

In the second quarter of the year there were some **developments in the corporate bonds market** on the Bulgarian Stock Exchange - Sofia AD. In May the issue of United Bulgarian Bank was registered, which was also the first one to be sold through the new segment of initial public offering on the exchange. The issue had an initial amount of BGL 15 m., maturity in 2005 and a coupon of 7.5 percent on an annual basis payable every six months. Selling was completed in June with 10 941 bonds sold each of face value of BGL 1,000. In June the exchange registered for secondary trade the first issue of mortgage bonds of Economic and Investment Bank AD amounting to BGL 1 674 610 and divided into bonds of face value BGL 10 each with a coupon of 7.25 percent on an annual basis with three-month interest payments. The maturity of this issue is in 2004. The second issue of mortgage bonds of the Bulgarian American Credit Bank AD was also registered for secondary trade (amount EURO 5 500 000, divided into shares of EURO 1,000 face value each and a coupon of 7 percent on an annual basis with six-month interest payments). The maturity of this issue is in 2005.

Two events of the second quarter, which are not related to the current market condition, should be noted. In May the Bulgarian Stock Exchange Sofia AD and the Moscow Inter-bank Currency Exchange signed a memorandum of cooperation with the purpose of stock markets development and attracting investments to the companies in both countries. Shortly prior to its signing the Board of Directors adopted new rules for concluding privatization transactions through public offering (the Combined Closed Auction) and for concluding of transactions with compensatory instruments on the stock exchange. The State Securities Commission approved of these rules at the end of the second quarter.

Environment for Development of the Capital Market

Immediately after the end of the second quarter the Council of Ministers adopted an annual list of 1 073 companies with state ownership, in most cases minority, stakes of which may be sold (by means of various privatization methods including public offering through the stock exchange) against compensatory instruments and investment bonds.

At that same time some bylaws were also adopted, which settled the issuance of compensatory instruments and transactions in them.

Expectations from these measures specifically with regards to the capital market development in the forthcoming months are in two directions. Firstly, the new framework for the transactions with compensatory instruments, and most of all, the concentration of the trade on the Bulgarian Stock Exchange - Sofia AD, would result in better transparency and clarity in the pricing, higher liquidity, and thus indirectly also in recovering the trust in securities trading and in the capital market in general. Secondly, the sale through the stock exchange of new blocks of shares on behalf of the state, even against non-monetary payment means, would raise the trust in the privatization process and the direct interest to the exchange.

The Council of Ministers' Resolution should be viewed in the light **of the overall state policy towards enhancing the capital market**. This Resolution in essence complements another list, adopted earlier in the year by the Council for Structural Reform, with blocks of shares and companies destined specifically for privatization through the exchange. This list remained non-public in spite of the numerous comments and official statements on it. The new list of companies for privatization against non-monetary means of payment does not allow per se for making categorical forecasts regarding the appearance of new companies to be traded on the Bulgarian Stock Exchange - Sofia AD, because the procedure for their conversion into public companies will take time.

It is namely **the lack of clarity on the matter of privatization through the exchange** that casts doubt on the prospects, at least the short-term ones, for revitalization of the capital market in Bulgaria. Such a conclusion is confirmed also by the fact that there was a violation of practically all deadlines stated in the new Program for Capital Market Development and Enhancement in Bulgaria, which was distributed in March.

The adoption of the Act on Amendment of the Public Offering of Securities Act, however, may be evaluated as a positive step and a manifestation of the government policy; this act has been the subject of long discussions in the recent months, and it was adopted and promulgated at the end of June (The Official Gazette No. 61 of 21st June 2002). The amendments to this act became necessary mainly due to the need of adjustment of the imperfections of the Public Offering of Securities Act, adopted at the end of 1999, and also the gaps in the regulation that became known in the course of implementation of the Act.

The amendments are aimed at reinforcing confidence in the capital market, protection of the rights of minority shareholders and investors, strengthening the powers of the State Securities Commission, and corporate governance development. **The new texts of the Public Offering of Securities Act change substantially a number of relations connected to the operation and development of the market** – for example in areas like capital increase and decrease, tender offering, information disclosure, public companies management, and the public statute per se.

The perfection of the statutory framework and the other acts of the state policy are traditionally present in Bulgaria's capital market review. One of the reasons for that is the fact that this market in Bulgaria is still not able to overleap the initial stage of development and to become a real alternative of the banking brokerage, or an environment for encouraging investments. That is why it has been quite natural for the capital market in the recent months **to become also one**

of the areas, on the grounds of which the Bulgarian government's economic policy is assessed in general. This critical view on the capital market comes against the background not only of Bulgaria's traditional expectation for support namely from the government, but is also due to the clearly declared intentions in 2001 for a much more active government policy in support of the development of this market.

The conclusion is that **alongside with the objective condition of the capital market (according to the condition of the trade at the Bulgarian Stock Exchange - Sofia AD), the review of the environment for development and the government policy per se also results in contradictory assessments.**

The expectations for the capital market development in 2002 still remain contingent upon the prospects of privatization via the stock exchange and, in particular, upon the quite new provisions regarding the transactions in compensatory instruments.

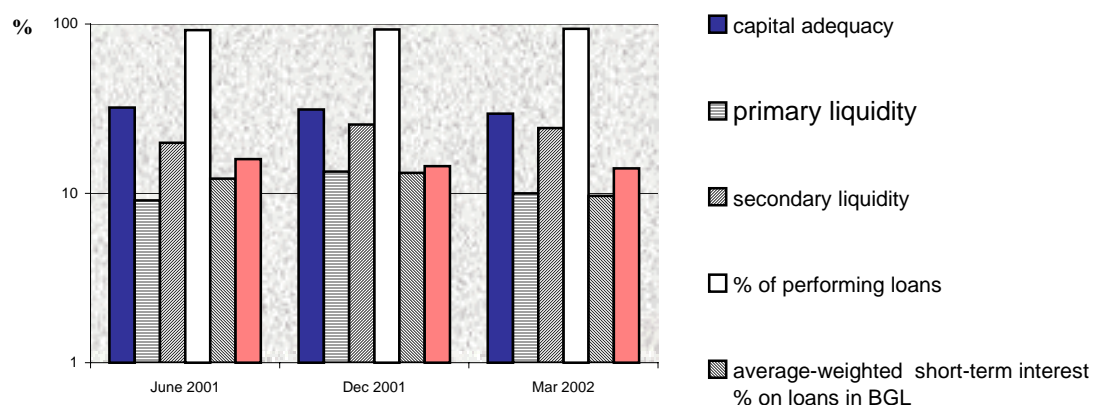
BANKING SYSTEM

The banking system is dominant in Bulgaria's financial sector. The condition of the banks in Bulgaria continues to be characterized as stable, with excellent capital adequacy and liquidity indicators, and at the same time the bank supervision functions well. As of the end of June 2002 in Bulgaria there are 35 banks, of which 27 banks have a license to conduct business in Bulgaria and abroad, one bank has a license to perform activities only in Bulgaria, and seven are the branches of foreign banks.

Banking System Indicators

A three-month period is too short for finding out long-term and lasting trends, but nevertheless here is what some of the indicators for the banking system in general look like. According to data from the Bulgarian National Bank (BNB) as of the end of June 2002 the banking system assets amounted to BGL 12 394 798 000, while as of the end of March they amounted to BGL 12 710 381 000 (this is a BGL 315 583 000 decrease during the second quarter of 2002). As of the end of June deposits amounted to a total of BGL 9 632 734 000, while as of the end of March they were BGL 9 929 055 000 (a decrease by BGL 296 321 000 in the second quarter of 2002). The current profit of the banking system for June was BGL 132 715 000, while for March 2002 it was BGL 56 996 000. In the last month of 2001, however, the current profit of the banking system was BGL 319 375 000. According to data from the information newsletter of the BNB the total capital adequacy of commercial banks as of the end of March 2002 was 29.52 (Group Five excluded), while this indicator had a value 31.32 percent as of the end of 2001 (and 32.05 as of the end of June 2001). As of the end of March 2002 the primary liquidity for the banking system as a whole was 9.99 percent, and the secondary liquidity was 24.25 percent (as of the end of 2001 these indicators were 13.47 and 25.47 percent respectively, and as of the end of June 2001 – 9.07 and 19.91 percent respectively). These indicators are shown in Figure 10 below.

Figure 10.
Selected Banking System Indicators



Logarithmic scale.

Source: data from the BNB, monthly information newsletters

Thus, the banking system as a whole had a decrease of assets and deposits in the second quarter of the year. This is accompanied, however, by an increase of the current profit, which is a sign of unutilized potential for more intensive and more efficient development of the banking system. Current profit of the banking system was in the course of increasing (similarly to the first three months of the year), but in June it was still smaller than last month and than that in May 2001. Capital adequacy indicators as of the end of March were lower than both those at the end of 2001 and the end of June last year, but nevertheless they were relatively very high and indicate the stability of the system. Liquidity indicators also show certain decline over the three months as compared to the end of 2001, but still they are better than the same indicators for June 2001. All this, again, may be interpreted as an indication that **the banking system of Bulgaria is stable, but the trends are contradictory and, furthermore, it still remains insufficiently efficient and underdeveloped.** This conclusion is indirectly confirmed also by the review of banks' lending activity.

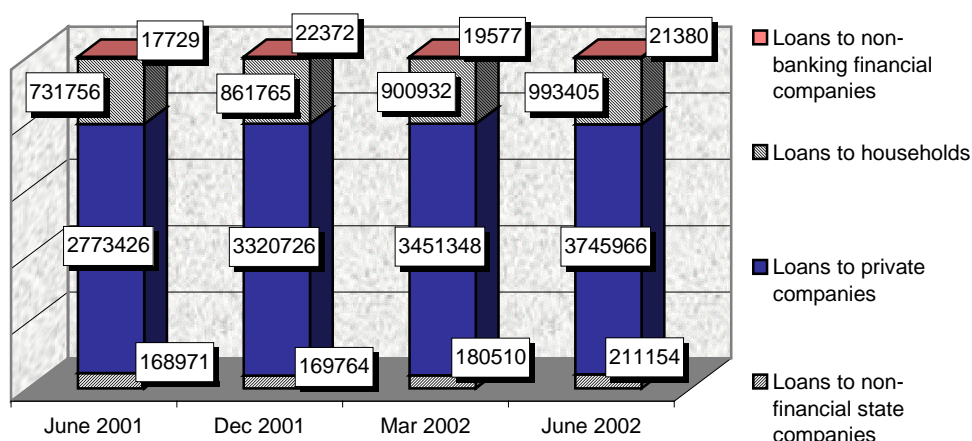
Lending Activity

Given the unavailability of many of the products and services offered by similar institutions in the West, lending activity is usually considered to be one of the key indicators of the degree of development of the banking system and its efficiency. **Loans to the non-governmental sector show a clear up-going trend** (under the currency board regime these are the loans extended by commercial banks, which include loans to non-financial state companies, private companies, households and non-banking financial companies). At the end of the second quarter of 2001 receivables on loans to the non-governmental sector were BGL 3 691 882 000, and from this level they reached BGL 4 971 905 963 000 as of the end of June 2002. Newly negotiated loans from commercial banks in the first five months of 2002 amounted to a total of BGL 1 877.3 mЛ, while for the same period of last year the newly negotiated loans were a total of BGL 1 349 m. **The loan portfolio quality is improving, too** – while at the end of the second quarter of 2001 92.01 percent of all types of loans in the banking system were classified as performing, this indicator was 92.98 percent at the end of 2001, and 93.5 percent at the end of March 2002 (See Figure 10).

Interest rates on short-term and longer-term loans denominated in different currencies continue to decrease (again Figure 10), however **loans' dynamics shows some interesting short-term trends** (in terms of currency, maturity term, and borrowers). For example, the review of loans to the non-government sector shows an increase in the loans exposure simultaneously to all groups of borrowers, where their relative share remains almost unchanged (Figure 11). Figures 12, 13 and 14 show the dynamics of newly agreed loans for the comparable periods of 2001 and 2002. With the newly negotiated loans, in particular in the first five months of the current year compared to the same period of last year, 2001, there is a trend of increase (generally, in terms of currency and maturity term) of the new loans by months in the respective periods, however, **short-term loans continue to prevail** (a certain exception is observed with the loans in EURO).

Figure 11.

Loans to the non-government sector (in thousand BGL)

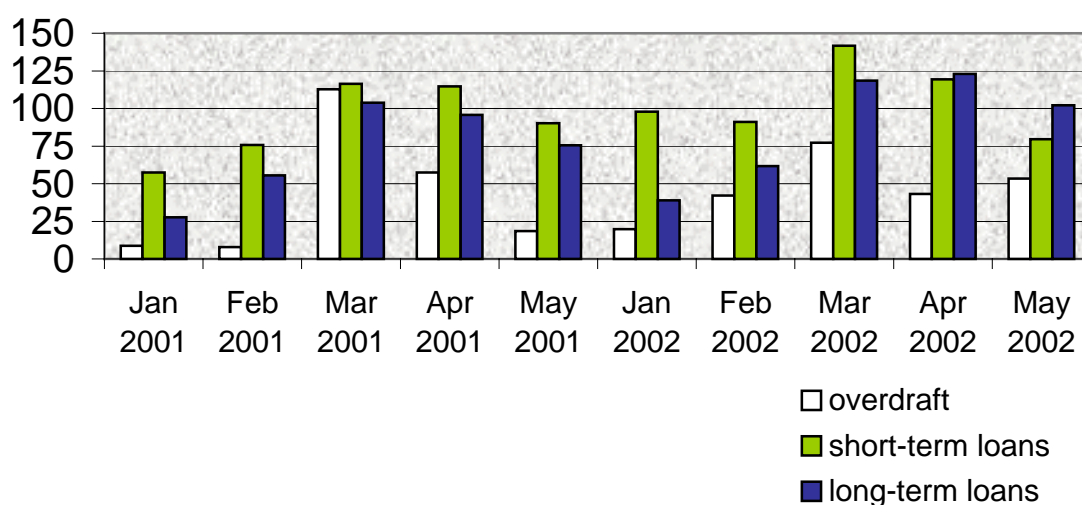


Source: data from the BNB, monthly information newsletters

The above may be interpreted as an indication of the condition and prospects of the Bulgarian economy as a whole, or in particular, of the attractiveness of investment projects, similarly to the capital market situation described above. With the development of economy and the occurrence of attractive projects, alongside with expansion of competition and the efficiency in the banking sector per se, more intensive long-term lending to the private sector may be expected. For the time being, **in spite of some objective indicators of an improvement trend, the assessment prevails that lending activity of the banks in support of the companies, including small and medium-size enterprises - is still weak.**

Figure 12:

Newly Negotiated Loans from Commercial Banks - in BGL (million BGL)

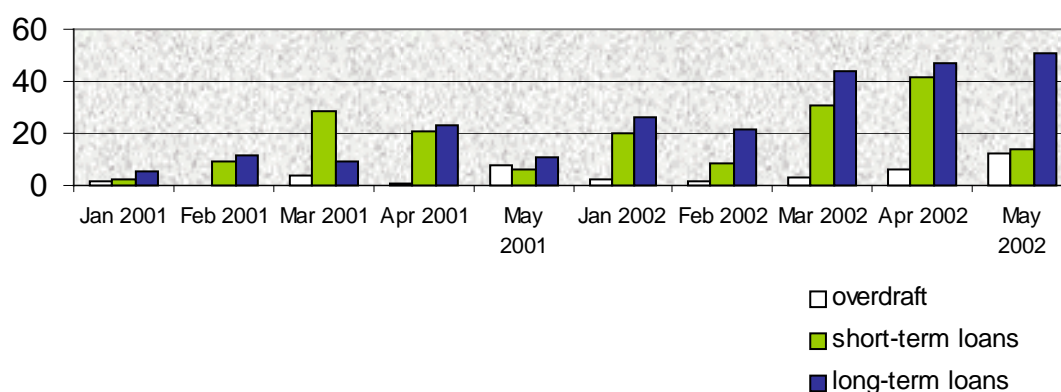


Source: data from the BNB, monthly information newsletters

Source: data from the BNB, monthly information newsletters

Figure 13:

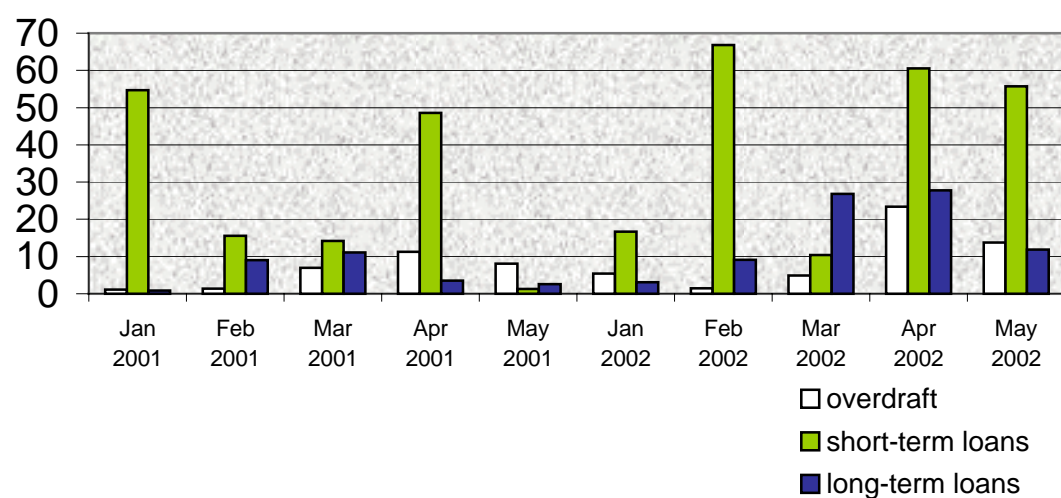
Newly negotiated loans from Commercial Banks - in EURO (million BGL)



Source: data from the BNB, monthly information newsletters

Figure 14:

Newly Negotiated Loans from Commercial Banks - in US \$ (million BGL)



Source: data from the BNB, monthly information newsletters

The availability, or shortage, of good projects, however, is not the single problem with bank loans. What is of importance also is the strongly conservative policy in the recent years affected by the 1995–1997 banking crisis aftermath and having its manifestation in the highly raised and often difficult to meet requirements to loan collateral. Some of the hopes for a more intensive lending activity are related to **the amendments to the statutory framework, which were passed several months ago and are aimed at fostering bank lending.** For example, the amendments to the 2002 Corporate Income Tax Act exempted bank loan interests from the

regulation on poor capitalization. The amendments to the Penal Code removed criminal liability of bank managers responsible for the granting of certain loans.

Restructuring and Privatization in the Sector

The analysis of the Bulgarian banking system should obligatory take into account also the ownership restructuring of the recent years. Through the different privatization channels, opening of representation offices, branches and newly established banks, **the foreign participation in Bulgaria's banking system is already prevailing both in the equity control and in the assets under management.** According to the data published by the BNB²⁰ private banks account for 80.1 percent of the total banking system assets as of the end of 2001. The group of foreign banks' branches (which constitutes only a part of the foreign participation in the Bulgarian banking system) in 2001 held 8 percent of the assets, 8 percent of the deposits and 15 percent of the loans in the banking system. In 2001 foreign investors had control over three times larger banking assets than local investors.

Privatization procedures for the last large state-owned banks are expected to be finalized these months, the attention being directed again towards the foreign investors. At the end of the second quarter expired the deadline for submitting tenders under the bidding procedure announced by the Banking Consolidation Company for selection of a consultant for the privatization of the State Savings Bank (DSK) AD (Joint-stock Company). In July five potential candidates were short-listed, from among which, on the basis of additional presentations later on, the final consultant, namely J P Morgan, was selected. Concerning the sale of the other bank, Biochim AD, in May the first stage of the tender for the privatization was brought to an end with a short-list of three candidate-buyers, from among which the Banking Consolidation Company selected Bank Austria to be the exclusive buyer. In June the Banking Consolidation Company approved of the draft contract for the sale of Biochim AD.

Statutory Framework Development

No amendments were made to the legal framework in the second quarter of the year, although there were suggestions for amendments. In March 2002 two drafts for amendments to the Banking Act were put forward to the National Assembly, and these were adopted after the end of the second quarter, namely in July. The first draft law proposed removal of the restrictions regarding the type of educational background required for bank managers. According to the arguments submitted by the proponent this proposal is in the light of the policy for banking sector liberalization, and it repeals the unnecessary restrictions to the conducting of banking activities. The second draft law was aimed at granting wider powers to the BNB for exercising control over the offshore shareholders in the banks that hold 3 percent and more of the voting shares. The proposal was justified with the need of strengthening the bank supervision, ensuring transparency in the shareholding structure and compliance with international regulation standards.

In April the Association of Commercial Banks came up with a formal **proposal for amendments to the Banking Act, which would allow banks to sell insurance and social security products based on commission-payment principle.** According to the arguments submitted by the commercial banks' representatives this will expand and support the basic

²⁰ Source: 2001 Annual Report of the BNB

banking activities without changing the extent of risks undertaken insofar as such transactions will be performed on behalf and on the account of the relevant insurance or social security company. Such a resolution would be in harmony with the universal nature of the Bulgarian banking system, however, the regulatory aspects relating to reasonable banking activities and consumers' protection should be cautiously evaluated.

A draft-act for amendments to the Bulgarian National Bank Act was put forward to the National Assembly in June. The main proposal therein was that opening and closing down of BNB branches in Bulgaria and abroad should be done only with the prior approval of the National Assembly. It proposed also that BNB branches should have the powers to sell and buy government securities.

This Bill was justified by the willingness to counteract the resolution of the BNB for closing down three of its regional branches – in Rousse, Bourgas and Vratsa. Although the Managing Board of the BNB passed a resolution to that effect as early as in 2001, the deadline for closing them down in October of the current year was coming closer, which aroused dissatisfaction among those concerned and resulted in the putting together of the above mentioned draft. Representatives of the BNB itself strongly objected to this²¹. On the one hand, they justify their resolution with the need of optimization of the regional structure and general increase of the BNB efficiency. On the other hand, the BNB views the draft as an encroachment upon the independence of the Central Bank of Bulgaria.

The matter about the BNB regional branches is partially related also to the problems of the cash services to the commercial banks. In this respect, a substantial change in the recent-years' relations with the commercial banks would be brought about by **the resolution of the BNB Managing Board for introduction of General Conditions for Cash Services to BNB Customers with Notes and Coins Packed as Valuable Consignments**. These General Conditions entered into force in mid-June and at the beginning also aroused negative responses, this time on the part of the banks. They voiced arguments about the potential increase of their costs and raising the costs for the clients; the BNB counter-response to these arguments was to point out the need of optimization of its own activities, adequate evaluation of such operations with commercial banks and getting closer to the international practice.

In May the National Assembly **passed at first reading the Bank Bankruptcy Act**. The delayed adoption of this Act was among the problems pointed out in the review of the latest agreement with the IMF. The draft was put forward as early as the end of September last year. Pursuant to it the administration of the Bankruptcy proceedings will be assigned to the Bank Deposits Insurance Fund. Further on, new control on the receivers' activities will be introduced and the functions related to it will be assigned to the Bank Deposits Insurance Fund, too.

What remained beyond the second-quarter period was the adoption of amendments to BNB Ordinance No. 3 on Payments, which was actually the last step preceding the introduction of the **new payment system for real-time gross settlement** planned for October 2002.

²¹ See Interview with Sv. Karaneshev, BNB,, for Econ.bg, 17 July. Available at <http://www.econ.bg/advice.html?type=3&lang=1&id=5126>

Social Security

The main topics discussed in the second quarter of the year were the suggestions placed by the Ministry of Labor and Social Policy (MLSP) and the National Social Security Institute (NSSI) for: introduction of minimum social security thresholds per economic sectors and professions on 1st January 2003; mandatory registration of labor contracts at the NSSI; postponing the equal division of the social security contributions responsibility between employees and employers; and the procedures on investing abroad the assets of pension insurance companies and of the supplementary pension insurance funds.

The data from the Individuals Register with the NSSI shows that in 2001 approximately 500 000 employed workers had their social security paid by the employers on the basis of an income lower than BGL 100. The widespread practice of paying social security contributions on the basis of the minimum monthly salary strongly undermines the foundation of the implemented reforms in Bulgaria's social security system and is the reason for questioning the achieved results.

Concerns are caused by the fact that every next year the Act on the Budget of the State Social Security lays down **increasingly higher deficit in the Pensions Fund**, which is covered through target subsidies from the state budget. For the year 2000 the planned deficit was approximately BGL 140 m., for 2001 – approximately BGL 442 m., and for 2002 – approximately BGL 668 m.

The idea of introducing a minimum insurance income for individuals working under labor contracts (and other contracts having the same legal effect) was submitted for discussion in the form of a draft prepared by the MLSP and the NSSI. The draft contains a list of suggested levels of such insurance income for 9 basic professions in 31 sectors, divided into 6 groups. **This draft is aimed at creating conditions for normal competition among the companies with regards to the labor market, preventing the payment of remuneration that has not been formally regulated, which results in tax and social security evasion.** This is an attempt to protect the good-faith employees and employers, to achieve social fairness and to expand the range of people, who pay social security contributions. The draft in general enjoys the support of the Bulgarian Business Association, the trade unions (the Confederation of Independent Trade Unions in Bulgaria, Podkrepa Labor Confederation, and Promyana Association), the Bulgarian Industrial Business Association (BIBA), as well as of some scientific and research institutes.

The idea on introduction of differentiated social security contributions per groups of professions and sectors involves also certain **risks**, such as evasion to the informal sector, closing down of jobs due to the higher cost of labor, reduction of labor remuneration to the level of the minimum insurance thresholds by employers that used to act in good faith by now, attempts for labor relocation to jobs, for which the thresholds are lower, and fictitious reduction of the working hours.

With a view to efficiently combat against gray economy, the introduction of minimum insurance thresholds **needs to be combined with a mandatory registration of labor contracts at the NSSI, higher awareness and social security education of the population, and coordination of the activities among the NSSI, the Tax Administration, the Labor Inspectorate, the Mol and the Employment Agency.** Control mechanisms need to be introduced in order to prevent abuses with job descriptions and to avoid discrepancies between the data in the official records of companies and the average salary as established through surveys by the NSSI.

In connection with the adopted government policy for reduction of direct taxes and increase of income disposable for spending, it is expected that there will be a delay in the setting of social security responsibility on an equal basis between employers and employees. At present the ratio of contributions paid to the Social Security System by the employer and the employee is 75:25. The government's intention is to maintain this ratio in 2003 and 2004, and in 2005 and 2006 this ratio to become 70:30.

The single Article in Decree No. 103 of the Council of Ministers dated 18th May 2002 provides for **a new amount of the social pension for old age: BGL 46.64 per month, in force as of 1 June 2002**, and by Resolution No. 1.2 as per Minutes No. 6 of 15th April 2002 in compliance with Article 100 of the Mandatory Social Security Code (MSSC) the Supervisory Board of the NSSI **determined for 2002 the coefficient 1.06 for updating the retirement pensions granted in the period through 31 December 2001.**

On 1 January 2002 the supplementary mandatory pension insurance with a universal pension fund was launched; it covers individuals born after 31 December 1959. **As of 26 March 2002 the NSSI started transferring the collected social security contributions**, for which a crosscheck had been made with the data in the Individuals Register, to the registered universal pension funds (UPF). **As of 5 June 2002 the social security contributions transferred by the NSSI to UPF amounted to BGL 8 898 175.74.** The largest portion of social security contributions was channeled to Doverie UPF - BGL 3 045 684.85 (34.23 percent), followed by: Allianz Bulgaria UPF – BGL 2 164 527.17 (24.33 percent) and Saglasie UPF – BGL 1 139 854.13 (12.81 percent). The total number of UPF subscribers as of 5th June 2002 was 1 011 209 individuals. Doverie UPF (396 011 individuals), Allianz Bulgaria UPF (206 532 individuals) and Saglasie UPF (129 172 individuals) have attracted the biggest number of individuals for pension plans.

The social security contributions transferred by the NSSI to the Occupational Pension Funds (OPF) as of 5th June 2002 amounted to BGL 7 724 302.19. The biggest amount went to Doverie OPF - BGL 2 544 904.25 (32.95 percent), followed by: Allianz Bulgaria OPF with BGL 2 173 722.12 (28.14 percent) and Saglasie OPF with BGL 1 525 487.67 (19.75 percent). The total number of individuals having pension plans with OPF as of 5 June 2002 was 156 702 individuals. The biggest number of individuals has been attracted by Doverie OPF – 56 079 individuals (35.79 percent), followed by Allianz Bulgaria OPF – 34 187 individuals (21.82 percent), and Saglasie OPF – 29 409 individuals (18.77 percent). Compared to 31st March 2002 the total number of individuals having pension plans with OPF has increased by 9 493, that is by 6.4 percent.

According to data from the State Insurance Supervisory Agency (SISA) **the eight voluntary pension funds had 478 523 individuals insured as of 31 March, which is 6.06 percent more**

than those insured as of 31st December 2001. Compared to 31st December 2001 the assets of the voluntary pension **funds** have increased by 6.62 percent. The biggest number of insured members have been attracted by Allianz Bulgaria Pension Insurance Company – 52.87 percent of all pension insured. Next comes Doverie Voluntary Pension Fund (VPF) with 17.46 percent and Bulgarian Pension Insurance Company PIC with 7.8 percent. Allianz Bulgaria VPF ranks first also in terms of the voluntary pension plans' relative share of the total amount of assets with its 64.73 percent. It is followed by Doverie VPF (17.00 percent) and Lukoil-Garant Bulgaria VPF (6.80 percent).

The structure of **investments of the voluntary pension funds as of 31 March 2002** shows that the pension insurance companies continue to restrain from investing the Voluntary Pension Fund money abroad. At that time the order for making such investments had not been completely settled. **The law restrictions, as well as the lack of sufficiently attractive investment instruments, are the reason why the voluntary pension funds invest mostly in securities issued and guaranteed by the state (46.93 percent) and in bank deposits in Bulgaria (36.23 percent).**

Ordinance No. 4 of the Ministry of Finance of 31 May 2002, promulgated on 14 June 2002, stipulates the procedures for investment abroad of the assets of pension insurance companies and of supplementary pension insurance funds. The objective is to protect the interests of the insured individuals by observing the principles of good investment practices, reliability, liquidity, profitability and diversification, thus encouraging pension insurance contributions with private pension funds. A recommendation is given towards investment of the assets in securities traded on the regulated markets of countries, with which Bulgaria has signed covenants on encouragement and mutual protection of investments. With a view to the protection of the insured individuals' money, in case the rating of certain debt instruments falls below the minimum required assessed level, the pension insurance company is obliged to sell these securities within seven days after the change is announced.

Control over the funds invested abroad will be performed by the SISA through setting up of registers of the pension insurance companies and the supplementary pension insurance funds; the registers will contain data about the investments abroad showing the types of securities, quantity, value in Bulgarian leva and the respective currency, rating, etc. A connection will be maintained between the depositary banks in Bulgaria and the foreign depositary institutions, and the SISA will provide the Ministry of Finance with information about the assets invested abroad. Thus it will be possible prompt measures to be taken against potential misuse of the money of insured individuals.

Bulgarian pension insurance market is witnessing the process of merger of the fourth biggest pension insurance company, the Bulgarian Pension Insurance Company, with Doverie Pension Insurance Fund. After the Commission for Protection of Competition and the SISA grant permission, it is expected that seven pension funds will remain on the market with a view to more efficient management of the insured individuals' money.

Further changes in the pension system are forthcoming and it is difficult at present to estimate when the problem with the deficit of the Pensions Fund will be resolved. The proposal by MLSP and NSSI for introduction of minimum social security thresholds per sectors and professions is an important step towards resolving this problem, however, it

requires time and mutual willingness for reaching agreement among the employers, trade unions and MLSP.

Employment and Unemployment

In the second quarter of 2002 unemployment maintained its level above 17 percent without any considerable improvement or any initial higher demand for seasonal workers. The trend is towards inconsiderable decrease of the number of unemployed individuals due to the smaller number of cases of mass layoffs and certain revitalization of the private sector. As of 30th June 2002 the lowest unemployment rate from the beginning of the year was registered, namely – 17.79 percent (calculated on the basis of the economically active population according to the 2001 census data).

Besides the high unemployment rate, another serious **concern is related to the structural characteristics of unemployment.** The vulnerable groups of unemployed are people in advanced age, Roma people, long-term unemployed and the disabled. The problem with the long-term unemployed (who have been on the unemployment registers for more than 2 years) is especially severe. The relative share of this group of unemployed in April this year was 31.6 percent. On the other hand, they have lowest educational and qualification level, and have low mobility on the labor market. According to data from the Ministry of Labor and Social Policy about May 2002 68.8 percent of the unemployed, who have been on the registers for over 1 year, have a primary school or lower education, and 74.7 percent of those registered for over 2 years have a primary school or lower education. These people face enormous difficulties in finding a job and rely mainly on social assistance for their subsistence. Most of them are in active working age, however, due to the discrepancy between labor demand and supply they are permanently left beyond the labor market. Another impediment is the lack of motivation for finding a job, as well as in many cases their lack of labor discipline.

In this connection the **Ministry of Labor and Social Policy has prepared and plans to launch in the coming months the pilot National Program entitled From Social Assistance towards Providing Employment.** By means of this Program the different forms of subsidized employment will cover unemployed people in working age, who are in the most severe social situation. The development and implementation of such a program will be a new component of the active policy on the labor market and a better opportunity for creating employment, qualification and increasing the preparedness for finding a permanent job, where the groups covered by the program will also have social security for retirement, employment accidents and sickness.

The program for micro-credits through the so-called Guarantee Fund for Micro-Credits is advancing. During the first four months of the year it has extended 134 loans amounting totally to BGL 1 307 360 and the expectation is that 316 jobs will be opened. The program covers 67 municipalities in nine regions, where 32.2 percent of the unemployed reside, and the program is planned to be extended.

The expectations for the second half of the year are for a relative stabilization of the labor market situation with maintaining its current characteristics, furthermore that in May the amount of BGL 62 million, granted in the beginning of 2002 for active measures on the labor market, had already been completely spent. The limited financial capacity for creating subsidized employment and preferences for employers, who hire unemployed individuals of

age up to 29 years, single mothers, disabled and people from the other vulnerable groups on the labor market, will be an impediment to achieving a more considerable decrease of the unemployment rates. **It is difficult to forecast the pace of implementation of the forthcoming restructuring and privatization of a number of production units and companies, but even they will be a potential factor for unemployment rate increase.**

Income and Living Standards

The second quarter of 2002 was characterized by stagnation of the nominal income of the population and deterioration of consumer climate.

The consumers survey conducted by the National Statistics Institute in the second half of April 2002, shows a very small decline (i.e. pessimism) as compared to January. The only less pessimistic expectation of consumers in April was about unemployment and this compensates to a certain extent the deterioration in the other trust components, namely: financial situation of households – 1.7 points decline, general economic situation in the country –1.4 points decline, and savings –3.0 points decline.

In comparison with last year **inflation expectations remain traditionally high** against the background of generally low income of the population, but compared to January of the current year there is a smaller number of consumers, who expect rapid increase of prices in the next 12 months. On the other hand, in comparison to January the summarized balance of the opinions on this question, which takes into account the current condition of households' budgets, shows decline by 4.6 points, and this decline has been registered with most categories of citizens. What is more, for the first time after the recommencing of the surveys in January 2001 there was a negative value of the balance of the opinions regarding households' budgets even in the categories of consumers with the highest household income, and in the category of the self-employed. The pessimistic consumers' expectations observed in the second quarter of the year are backed up by the results obtained from the consumers survey conducted by the National Statistics Institute in the second half of July.

These subjective assessments and expectations are confirmed to a large extent also by the data about the dynamics of households' real income in the second quarter of the year compared to the second quarter of last year. The indicators of the general and cash average income per member of the household show a minimal growth, which lags behind the inflation rate. This discrepancy will probably not be compensated by the updating of pensions in force from 1 June, and the 5 percent increase of salaries planned for the second half of the year.

An indirect indicator of deteriorated financial situation of households is the trend towards increased relative share of the income from the self-subsistence farms, which in June reached 10.1 percent of the structure of the total income of households. Traditionally, summer months are the period when households handle more easily their subsistence, however, the increase of the electric power prices this year will aggravate the situation earlier than usual.

Similar are also the conclusions from the surveys of the households' consumption in the country, which are conducted by sociological survey agencies on a regular basis. The second quarter of 2002 was characterized by lower levels of consumption of the basic fast-turnover goods as compared to the same period of last year.

Social Partnership

The relations among the government, trade unions and employers were much more tense in the period April – June than in the first quarter of the year. The protests of the railway workers, longshoremen and the employed in education sector were only partially labor and social in nature, and the resolutions to the conflicts were reached through negotiations. To a no lesser extent they were also an attempt by the trade unions – the Confederation of Independent Trade Unions in Bulgaria and the Promyana – to establish themselves as a factor in shaping up of industrial relations in Bulgaria, as well as to intervene in political life. The unfinished restructuring of a number of sectors and economic activities, as well as the forthcoming optimization of the state expenditures in education and health care will continue to generate social tension.

Another aspect of the conflict between trade unions and employers occurred as a consequence of **employers' willingness to see substantial amendments to the Labor Code, which was made more explicit in the common stand and suggestions prepared by them.** The latter were put forward and considered by the governmental Council for Economic Growth. The draft for amendments to the Labor Code prepared by employers' associations is about to be put forward and discussed in the Tri-partite Council for Social Partnership. Some trade union leaders defined these employers' actions as "declaring war on trade unions". Given this situation, difficult and prolonged negotiations between the parties may be expected, where the government will be called for as an arbitrator.

Employers associations' proposals for amendments to the Labor Code are aimed at liberalization of the labor market in Bulgaria and have the support of the IMF and the World Bank experts. Similar ideas of greater flexibility of the labor market are discussed and applied in other countries, too, for example Italy and Poland. The suggestions are towards: removal of a number of restrictive measures when using fixed-term labor contracts, the procedures for dismissal from the job, using overtime labor, as well as reconsidering the responsibilities for payment of indemnification and taking leaves. These measures are viewed by employers and international experts as a means for increasing the labor resources mobility in Bulgaria, and ultimately, for reducing unemployment.

In the period April - June the discussions and preparation for establishing a **guarantee fund for employees' receivables in case of insolvency or liquidation of the company became more intensive.** Public consent is in place regarding the need of such fund, given the fact that as of the end of 2001 employers were liable to pay the workers and employees a total of BGL 204 288 000. The amount of only the salaries overdue to over 5 000 individuals in 229 companies, which have been declared in bankruptcy or liquidation, is BGL 32 million. The draft foresees a part of the contributions to the Unemployment Fund to the amount of 0.4–0.5 percent to be redirected to the above-mentioned Guarantee Fund. Alongside with that, there is a number of questions, mutually acceptable answers to which should be found by the Ministry of Labor and Social Policy and the social partners by the end of the year, such as: the portion of the contributions to the fund for which the workers are liable, the amount of the liabilities to be covered by the fund and the range of individuals and companies, and the fund management.

An interesting new point is also the experiment with the establishment of **the first workers' councils in some private companies** in Bulgaria that follow the German model of dialogue

between employer and workers at the company level. This experiment enjoys the support of the Employers' Union in Bulgaria and its purpose is to concert the interests of the labor force and the owners by means of direct negotiations on the labor conditions in the particular company. For the time being the project faces a moderate opposition by the trade unions, which see it as a threat to them of losing territories that they have already conquered. In case this new form of social dialog finds wider multiplication, or steps are taken for its regulation by law, then this will be one more reason for tension in the relations between employers and trade unions.

HEALTH CARE REFORM

The opinion that the health care reform is in a deadlock is commonly spread. If private health insurance is not enhanced, if no control is exercised over the management of the funds of the National Health Insurance Fund (NHIF) and the privatization of health care establishments is delayed or is unsuccessful, then lasting unfavorable trends in the health care may be expected. In the second quarter of the year the main discussions in the health care sector were related to solving of the problem with free medicines, strengthening control over the NHIF and the introduction of rules regarding privatization of health care establishments.

In the context of promised by the government reduction of the total taxation and security burden, **the rate of mandatory health insurance is planned to remain 6 percent.** The Ministry of Finance suggests that employers continue to pay 75 percent of the health insurance contributions for their employees until 2004. Only in 2005 the ratio of the employers' and employees' responsibility for health insurance is expected to become 70:30.

In the middle of the year there occurred **a strong shortage of funds for the free medicines, which are paid by the NHIF.** Approximately BGL 100 million for free medicines are short, and another BGL 100 million are required in order to add further diagnoses to the list for in-hospital treatment, which is paid by the NHIF. The reasons for the large overspending of the NHIF is the insufficiency of funds planned in the NHIF budget, the lack of an information system and the insufficient control over the funds of the NHIF.

With a view to supervision over the allocation of **free medicines, as of 1 July they are given out with special stickers on them.** This measure was undertaken in order to discontinue the resale of medicines paid for by the NHIF, which are billed by pharmacies, but not received by the patients.

According to reports in the press in June the work of the Health Care Commission was accelerated, and as a result some of the provisions of the Health Insurance Act, which were subject to discussions, were those referring to **the supervision over the activities of the NHIF and the voluntary health insurance companies.**

The NHIF structure provided for by law is not efficient enough and no sufficient control over the NHIF activities is stipulated, therefore **the Health Care Commission suggested the basic structure and bodies of the NHIF to be preserved, but the number of the Representatives' Meeting to be reduced from 54 to 36 members.** The intention is to maintain the representatives of the employers, trade unions, municipalities and the state, but their quotas to be partially changed: the state to have 12 representatives, and the trade unions, employers and municipalities – 8 representatives each. The purpose is to outline clearly the functions, rights and responsibilities of the Representatives' Meeting, the Managing Board and the Director, and to make the functions, rights and responsibilities of the Managing Board stronger, reducing the one-man power of the Director. **Consideration is being given to the idea that the NHIF should submit to the National Assembly beside the report on the implementation of its budget, also a report on its activities.**

It is planned that control over the activities of the companies for supplementary health insurance, as well as the issuance of licenses to new health insurance companies, be carried out by the Agency for Insurance Supervision (AIS), and not by SISA and the specialized Health Insurance Supervision with the Ministry of Health, because health insurance in its essence, according to the proponents of the draft, is much closer to insurance than to pension plans. With health insurance a risk is managed, while with the pension plans profitability of the invested funds is sought.

At the end of the second quarter **the Health Insurance Commission suggested rules for privatization of the former polyclinics,** which are to be stipulated in a separate chapter of the Health Care Establishments Act. The rules provide for maintaining the subject of activities and lease agreement conditions for at least 15 years, and for preserving the integrity of the health care establishments. The purpose is to avoid paying impossibly high rents by family GPs, maintaining the number of health care establishments, improvement of the quality of health care for the population, and investment of the funds from rent in equipment and in modernization of the doctors' rooms.

The problems in health care are much more numerous than those in the pension system. The success of the health care reform depends predominantly on the efficient management of the NHIF funds, the successful privatization of the health care establishments and the establishing of tax relieves with a view to enhancing the voluntary health insurance, where health insurance contributions have to be determined by taking into account the health risk of the insured. Private health insurance may be a good supplementing component, and at the same time partial competition to the NHIF, which situation will make it operate more efficiently.

Environmental Legislation

Expectations for adoption of a new Environment Protection Act were not met in the second quarter of 2002. This fact may well affect the deadlines for incorporation of the European standards into the Bulgarian environmental legislation. The introduction of the Seveso Directive (on limiting the risk of large accidents in using hazardous chemical substances in industry) and the legal regulation of processes relating to the registration of the environment control systems and introduction of eco-labeling is postponed. The section Industrial Pollution and Risk Management, to which the aforementioned legislation amendments belong, is one of the basic sectors, whose legal provisions have direct effect on the activities of economic actors.

Substantial importance to the operation of the national industry stems from **the adoption of the Ordinance on the Conditions and Order for Determining the State Liability for Environment Damages Caused by Previous Actions or Lack of Actions in Connection with Privatization.** This Ordinance specifies the liability of the state as a former owner for damages to the environment caused by past activities of the companies, and settles the conditions for funding the activities for remedy of the consequences on the environment from such past actions or lack of action. The Ordinance resolves a quite sensitive problem of the companies in Bulgaria and to a large extent will have a favorable effect on the privatization process.

In the second quarter of 2002 for the first time after the environment disaster caused in 1986 by the accident in the Chernobyl Nuclear Power Plant, statutory regulation was elaborated on the activities of radiation control of imported agricultural products for human consumption (Ordinance No. 10 of 18 April 2002 and Ordinance No. 11 of 18 April 2002).

Environmental Conditions

Keeping the public informed is one of the main principles of the national environmental protection policy. Official annual data about the condition of the environment in the Republic of Bulgaria were published in the second quarter of the year. The results of the environment survey conducted by the National Statistics Institute²² were announced, and in April the Council of Ministers approved the 2000 Annual Report on the Condition of the Environment in Bulgaria²³.

Through analysis of available information about the condition of the environment in 2000 we have noted two trends, which have specific importance to the policy for sustainable development of natural resources and the measures taken by the government bodies in the recent months.

²² See Okolna Sreda 2000 – Sofia, NSI, 2002

²³ See <http://nfp-bg.eionet.eu.int/soe2000/index.htm>

One of the main components, which characterize the correlation between economic activities and the environmental conditions, is air pollution. Harmful substances release in the atmosphere is a direct result of the economic activities. Referred to the GDP they characterize its energy-intensiveness and structure. In 2000 the biggest portion of the total releases in the atmosphere were due to the processes for energy generation (91 percent of the total release of sulfur oxides), and their quantity had increased by 7 percent as compared to 1999. Manifestation of this increase comes after a four-year (starting in 1995) trend of decrease of harmful substances releases into the air and is due to the increased electric power production volume at the thermal power plants, bigger consumption of brown and lignite coal for industrial purposes and higher sulfur content in the coal.

During the same period a trend towards an increase of sulphur oxides emissions was noted. From 0.076 tons per USD 1000 of GDP in 1999, they increased to 0.082 tons in 2000 and this means that **in 2000 the GDP was produced at the cost of bigger pollution of the environment**. Since the harmful substances emissions are accompanied by high-energy consumption per unit of the GDP, this is also an indicator of **decreased energy efficiency of production during that period**. Produced GDP per 1 KWh of the generated electric power has decreased from USD 0.32 in 1999 to USD 0.29 in 2000.

The above listed facts are of importance in the context of the Climate Change Protocol of Kyoto ratified by the National Assembly on 17th July 2002 and the activities stipulated in it. They once again raise the question about the compliance of the national environmental standards with those of the European Union Member-states and about the efficiency of the existing mechanisms for control and sanctions relating to the environmental legislation enforcement.

With a view to Bulgaria's preparation for participation in international sustainable development programs in the recent months the Ministry of Environment and Water has been acting more intensively to attract foreign investors and donors for institutional and investment projects relating to environmental protection. High-rank officials from the Ministry had meetings with representatives of the national business and foreign companies – suppliers of purification technologies and equipment. However, this activity has not been the result of a program put together in advance and containing specific objectives and priorities, clearly described procedures of involvement and control, and coordinated with the representatives of business organizations. Therefore, the above mentioned activity does not yet include the elements of a comprehensive policy and the expected results will hardly be of a scale commensurable with the problems, which they set themselves to resolve.

In support of the government efforts in April **the second tranche of the IBRD loan for support of environment and privatization was granted, amounting to EURO 14 840 000**. This second tranche of the loan was granted to support the balance of payments in exchange of the government's commitment to ensure funds under the state budget for financing the environment protection programs of several large enterprises. The loan is granted to Bulgaria against requirements met and measures taken by the government under the program for remedy of past environment damages and acceleration of the adoption of the EU requirements and practices for improvement of the environment conditions and indicators of the privatized companies. It has been designed as a structural operation, which supplements implementation of the reforms and restructuring of the real sector.

Beside the data on the atmospheric air quality, what deserves attention is the published statistics on water use and water supply in Bulgaria. According to the results obtained by the National Statistics Institute, 98.4 percent of the population in Bulgaria had access to water supply in 2000, of which 36 percent were serviced by drinking water treatment plants. Nevertheless, **under the conditions of water deficit**, when on half of the country's territory 80 percent of its population has a water-use regime, **the public water supply companies reported losses for 2000 amounting to 62 percent of the total quantity of water intake.**

It should be pointed out that the year 2000 is the year when the Waters Act entered into force and new type of water management – by means of the established 4 water-basin directorates for the territory of the country - was introduced.

The problems reported as early as two years ago, are still topical. In May the Council of Ministers put forward to the National Assembly **a Draft-Act on Amendments to the Waters Act**. This draft foresees stage-by-stage reduction of the percentage of operation costs, which the Water and Sewerage Companies calculate and include in the price of water supplied to the population. The expectation is that this measure will encourage companies' investments in renovation and modernization of the water-transfer systems thus achieving reduction in water losses in Bulgaria.

NEGOTIATIONS FOR ACCESSION WITH THE EUROPEAN UNION

In the context of the adopted Strategy for Accelerated Accession Negotiations of Bulgaria for accession with EU the government of Bulgaria continued pursuing its active negotiations policy and by the end of the EU presidency of Spain another 6 chapters were closed, with which the total number reached 20 (See Table 4).

Table 4.
Monitoring of Bulgaria's EU Accession Negotiations

Chapter	Condition as of 28 June 2002
1 Free Movement of Goods	Temporarily closed
2 Free Movement of People	Temporarily closed
3 Free Delivery of Services	Temporarily closed
4 Free Movement of Capital	Temporarily closed
5 Corporate Law	Temporarily closed
6 Competition Policy	Open
7 Agriculture	Open
8 Fisheries	Temporarily closed
9 Transport Policy	Open
10 Taxation Policy	Temporarily closed
11 Economic and Monetary Union	Temporarily closed
12 Statistics	Temporarily closed
13 Social Policy	Temporarily closed
14 Energy Sector	Open
15 Industrial Policy	Temporarily closed
16 Small and Medium Enterprises	Temporarily closed
17 Science and Research	Temporarily closed
18 Education and Vocational Training	Temporarily closed
19 Telecommunications	Temporarily closed
20 Culture and Audio-Vision	Temporarily closed
21 Regional Policy	Open
22 Environment	Open
23 Consumer Protection	Temporarily closed
24 Justice and Home Affairs	Open

25 Customs Union	Open
26 Foreign Relations	Temporarily closed
27 Common Foreign and Security Policy	Temporarily closed
28 Financial Control	Open
29 Financial and Budgetary Matters	Open
30 Institutions	Temporarily closed
Total number of closed chapters	20

Thus the objective for closing the maximum possible number of chapters by the end of June has been achieved, which also confirmed the certitude of Gorge Fuentes Monsonis-Vilayonga, Special Mission Ambassador of the Kingdom of Spain for the EU Enlargement, that Bulgaria can complete the negotiations by the end of 2003, which he expressed during his visit to the country in the beginning of April.

Three more chapters, on which Bulgaria was having negotiations with the EU, were closed on 22 April 2002. At a meeting of the Bulgarian negotiators team, headed by Meglena Kouneva, and the permanent representatives of the EU member-states to Brussels the chapters Economic and Monetary Union, Social Policy and Employment, and Institutions were preliminarily closed. The advancement of the country was supported also by the **Commissioner for Enlargement Gunter Verhoegen** who pointed out that with its rapid progress in the recent months Bulgaria had surpassed his expectations.

At that same time also a meeting of the **Commissioner for Enlargement Gunter Verhoegen** and the Minister of Energy Milko Kovachev was held; it became clear at the meeting that further talks will be held regarding the **closing down of Units 3 and 4 of Kozloduy NPP** and that a connection should be sought between the date for Bulgaria's admission to the EU and the date for closing of Units 3 and 4 of Kozloduy NPP.

In the Memorandum of 1999 Sofia has clearly expressed the understanding that there are differences in the position of Bulgaria and of the EU regarding Units 3 and 4. It is logical for this matter to be related to Bulgaria's accession with the EU – this is the case with Lithuania, and this is the case also of Slovakia. Notwithstanding the fact that the EU has already taken a firm position, it is our belief, that the consultations are a significant aspect of the European Union democracy, emphasized Milko Kovachev.

On 13 May 2002 the government approved of 2002–2006 Action Plan and 2002 Working Program under the Communication Strategy for preparation of Bulgaria's membership in the EU. The Council of Ministers also approved of the establishing of European Communication Council, which would be in charge of the strategic planning, monitoring and evaluation of the implementation of the strategy, the action plan and the working program. The objective of these documents is to coordinate and synchronize the activities of the government institutions and non-government partners by concerting them with the Communication Strategy approved of on 24 January 2002.

The draft of the 2002–2006 Action Plan and the 2002 Working Program specifies the priority actions oriented towards separate target groups in the Bulgarian society, as well as to the citizens of the EU member-states and the countries-candidates for EU membership.

At the end of May, following the proposal by the Prime Minister and by a Resolution of the National Assembly, **the Chief Official in charge of Bulgaria's negotiations with the EU was given the statute of a Minister of European Affairs** and will be directly involved in the state governance. With this the Deputy Minister of Foreign Affairs Meglena Kouneva becomes a minister in the current government. The Ministry of Foreign Affairs will assist the Minister of European Affairs in her work. The above-mentioned change raises the rank of the Chief Negotiator and thus emphasizes the importance that Bulgaria attaches to its accession with the EU.

The change is aimed at improved coordination among the ministries in their activities related to the European integration. The participation of the Chief Negotiator in the capacity of a minister in the work of the Council of Ministers will allow for more operative decision making regarding Bulgaria's membership in EU. In international perspective the above-mentioned resolution of the National Assembly raises the level, at which our country is conducting its negotiations with the EU.

Bulgaria has established the position Minister of European Affairs and this fact will show its European partners still more clearly its commitment to implement the required reforms and to adopt the best practices with a view to successful completion of the negotiations and our membership in EU in due course – these were some of the grounds stated by the Prime Minister Simeon Saxe-Coburg-Gotha when he suggested the change to the National Assembly.

On 10 June 2002 in the last-but-one round of negotiations under the EU Presidency of Spain Bulgaria completed successfully the negotiations on three more chapters, namely: **Free Movement of Goods, Free Movement of People, and Taxation Policy**. This took place in Luxemburg during the Sixth Session of the Ministerial Conference regarding Bulgaria's Accession with the European Union.

According to **agreements** reached on Chapter 1 "Free Movement of Goods", complete market access is provided to Bulgarian manufacturers, which is an incentive for improvement of the goods quality and their competitiveness. Thus Bulgarian manufacturers will benefit directly.

Closing of negotiations on Chapter 2 Free Movement of People results in settlement of Bulgarians' free access to the European labor market. Completion of negotiations on the 4 domestic-market freedoms: of goods, people, services, and capital, and the undertaking of accession responsibilities ensure for Bulgaria the prospect to enjoy equal rights and be an important part of the future 500-million market of EU.

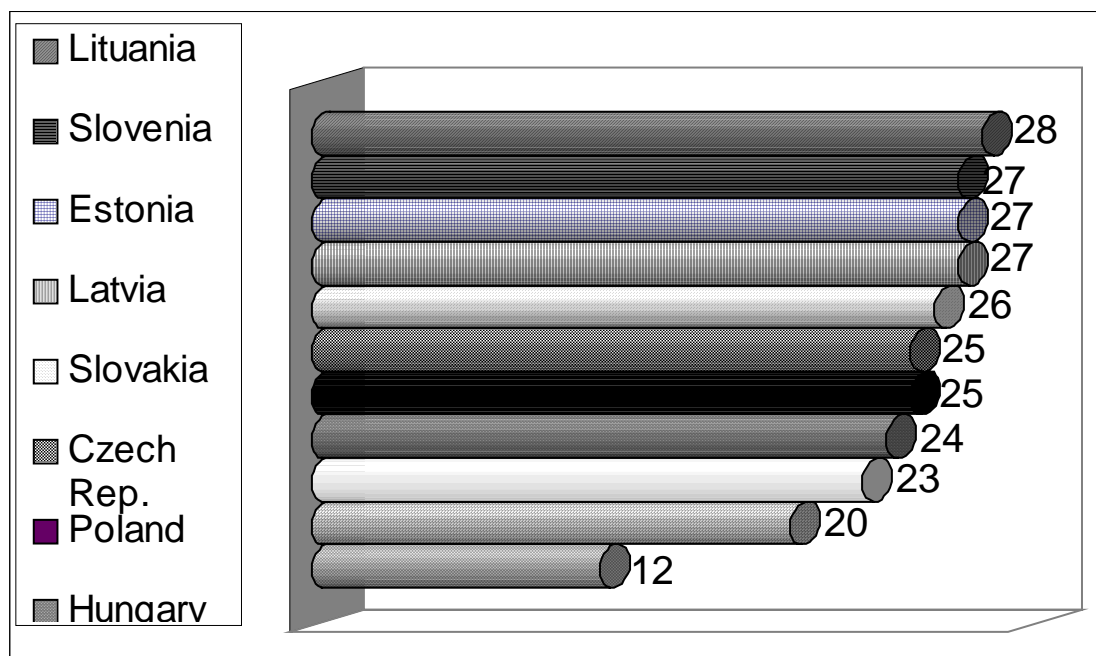
The agreements reached regarding Chapter 10 Taxation Policy establish strong anti-corruption mechanisms enhancing Bulgaria's economy. Closing of this Chapter is recognition of the far-sighted taxation policy of Bulgaria's government.

The Sixth Session of the Conference on Negotiations gave a positive evaluation of Bulgaria's efforts to negotiate at an accelerated pace. The Ministers of Foreign Affairs of EU member-states and the Bulgarian Minister of Foreign Affairs summarized the results of the

negotiations and pointed out that as a result of their joint efforts negotiations were closed on 20 out of all the 30 sections of the future Treaty for Bulgaria's Accession. Thus the negotiations moved forward into a new, concluding phase. **The earlier assessment given by the European Commission, which stated that Bulgaria had achieved a completely unique progress in its preparation for accession, has been confirmed.** Completion of negotiations also on the Chapters Economic and Monetary Union, and Industrial Policy is a recognition of the attained progress in establishing a functioning market economy in Bulgaria and outlines the prospect of the future accession with the Euro-Zone. The overall assessment of the negotiations process shows that 11 out of the 12 candidate countries, Bulgaria being one of them, have opened negotiations on all the chapters. Bulgaria ranks in the group of countries, which have closed between 20 and 25 chapters, among which are the Czech Republic, Hungary and Poland. (Chart 15).

Figure 15.

Temporarily Closed Chapters in the Negotiations for Accession
(by candidate-countries, as of 28 June 2002)



OTHER COMPONENTS OF THE BUSINESS ENVIRONMENT

Efforts towards improvement of the business environment continued in the second quarter of the year, too. The main areas where they are being implemented, are as follows:

Public Procurement

The Act on amendments to the Public Procurement Act (PPA) was promulgated in the Official Gazette No. 43 of 26 April 2002. These amendments were necessitated by the need to take into account the positions and regulations of the European Commission, to create more favorable conditions for encouraging competition and to raise the efficiency of the public procurement implementation. The newly adopted text of the PPA has a scope, which excludes operators of cellular telecommunication networks and private radio stations. This text does not contain the provisions regarding preferences for Bulgarian companies applying for public procurement provision. The initial text of the Act, which has already been approved at first reading, contained such a possibility, but it was left out from the final version of the text. It is expected that this matter will be temporarily settled by an ordinance of the government, but no such ordinance has been issued so far.

In was announced in the beginning of June that in 2003 a completely new Public Procurement Act would be adopted. Its preparation will start in the beginning of 2003. This step is required due to several reasons, the major of which is the need for Bulgarian legislation to incorporate two new EU directives regarding public procurement, which will enter into force in 2003. At this stage it is not known which provisions of the Act, which became effective recently, will be changed. Most probably it will be the new act that will provide for preferences for Bulgarian companies (for example, in the form of a 10 percent discount on the value of their tenders).

The need of amendments to the legislation (the PPA in particular) arose due to objective circumstances. At the same time, however, they are an evidence of one of the main business-environment problems pointed out by the entrepreneurs, namely the frequent amendments to the legislation.

Licensing Regimes

On 23 May the Council of Ministers made a decision on repealing of 74 licensing regimes, and on alleviation of another 120 such regimes. This is the first substantial step towards reducing the existing administrative barriers and shrinking one of the corruption sources.

After the analyses made, the inter-departmental group coordinated by the ASME, put forward suggestions for the above-mentioned amendments. Some of the initial suggestions of the working group were not accepted – in particular, those regarding some regimes in the system of customs and securities, the arguments being that the European legislation in these areas requires these regimes to be in place. Other suggestions for regime repealing were turned down, too: the licensing regime for production of compact disks and matrixes will be preserved as it is, instead of being transformed into a registration regime; the licensing regimes for

production of medicines and carriage in the Bulgarian-Romanian part of the Danube will also remain. The biggest number of suggestions have been made regarding alleviation and repealing of regimes in the system of the Ministry of Agriculture and Forestry: 23 for alleviation and 9 for repealing.

The comment on the performed activities in the field of licensing regimes requires to point out, that what **has been completed by now is only the first step towards lessening the administrative burden for the business. The resolution of the Council of Ministers refers to the principle, and it will be afterwards incorporated in specific laws, by-laws and other statutory acts – a process that will obviously be a more difficult and a longer one.** Currently a schedule is being prepared containing suggestions about the method and deadlines for the required amendments to the statutory framework.

There are several **positive developments** related to the future resolving of the problems in this sphere:

- The decision that the inter-departmental group should continue to exist in the future – it may play the role of a supervisory body for the implementation of the decisions made;
- A register of the licensing regimes will be set up and a draft-act will be prepared, which will guarantee the need of introduction of such regimes in the future;
- Two mechanisms for control over the expediency of new regimes introduction are being discussed: establishing of a state-public body with powers regarding the regimes; or establishing a unit directly subordinated to the Prime Minister.

The above may ensure that the process of the regimes optimization will not be a campaign in nature, but a permanent one.

State Aid

In March the Parliament passed the **State Aids Act**, which entered into force on **20 June 2002**. Again in June the **Regulation on the Application of this Act was adopted**. Passing of the Regulation and the Act was in response to one of the main EU criticisms to Bulgaria – the lack of control over granting of state aids and monitoring over their spending. This is one of the conditions set for closing the Chapter Competition Policy.

One of the specific features of the Act is that it does not give an explicit definition of the term “state aid” and this is done deliberately, so as to rule out the opportunity of bypassing it. The state aids for agriculture and fisheries, as well as for the defense industry, are left beyond the coverage of the Act.

A specialized group headed by a member of the Commission for Protection of Competition (CPC) developed the Regulation. The objective of the Regulation is to give economic actors an opportunity to assess by themselves whether they are eligible to apply for state aid and for up to what amount, as well as to make the activities of the CPC transparent.

The main provisions contained in the Regulation are as follows:

- All state aids granted to companies in Bulgaria, regardless of their form, will be limited to a certain amount;
- CPC is the body, which will make decisions on granting state aids;

- The types of state aids that can be approved by the Commission are: for SMSs, for protection of the environment, for encouraging employment, for rehabilitation and restructuring of companies in difficulties, for R&D, for current costs for regional development, for training.

The above opportunities are stipulated in detail in the Regulation stating the requirements and criteria, which the aid recipient should meet. With this Regulation in place every applicant for state aid may determine by itself the maximum amount of funds that it is entitled to, and for this purpose a formula is provided, which is used for calculating the limits for each type of state aid.

Developments in this area are significant and necessary, however for the law to work, beside the Regulation also an Ordinance will be required regarding the monitoring of state aids and ensuring transparency of their spending. Further on, the MoF should keep a register of all state aids regardless of whether they have been granted or only applied for. The problem is, however, that no deadline for the establishing of such register has been stated and this fact may cause delay of the overall procedure.

Protection of Competition

One of the major problems pointed out by representatives of the business is the presence of unfair competition and monopoly behavior on the market. One of the ways of overcoming it is the legislation to be amended. **Work has been started on developing a draft for amendments to the Law on Protection of Competition (LPC).** An inter-departmental group headed by the Deputy Minister of Economy is preparing the draft. The intention is the amendments to enter into force in December 2002. The main amendments are related to encouraging competition and expanding CPC's powers in the following aspects:

- Restriction of cartel agreements - not only horizontal, but also vertical agreements, i.e. between supplier and distributor (expected effect – removal of the recommended prices of some products);
- Introduction of a clause on discontinuation of the operational and legal actions of companies, which plan concentration of economic activity (merger, acquisition, takeover of control and others, until the CPC announces its opinion);
- Expanding the CPC powers for gathering evidences under the dockets regarding the presence of a cartel agreement and abuse of monopoly market position;
- Extension of the term given to CPC to prove the presence of a cartel agreement.

The proposed amendments will be subject of discussion. It may be pointed out, however, even prior to the discussion, that a perfect organization is required in order to avoid abuses, corruption and fulfillment of political orders. The expansion of CPC's powers may become a double-edge sword: on the one hand, to improve the conditions for competition, but on the other hand, to foster corruption, racketeering and political pressure

Regulation of Bankruptcy Procedures

The Bankruptcy procedure in Bulgaria takes three and a half years and passes through 16 steps. In the last two years 1,320 bankruptcy proceedings were initiated or pending.

The change of this situation will require also **amendments to the Commercial Code (CC)** with the purpose to speed up bankruptcy procedures and to better protect creditors' interests. A

discussion on amendments to the CC to this effect started in June. The basis of the discussion is **the measures suggested by the Ministry of Economy, namely:**

- Reduction of the procedures for claiming and acceptance of receivables;
- Removal of subjectivism in determining whether a company is insolvent;
- Removing the rehabilitation plans and giving priority to out-of-court settlements;
- Possibility for receivers to be not only natural persons, but also juridical persons, and their remuneration to be determined as a percentage of the selling price of the assets;
- Annual evaluation of receivers in compliance with criteria determined by the Ministry of Justice, etc.

Most of the above listed proposals are quite radical and face opposition on behalf of lawyers in this area. At present a discussion is underway on the web site of the Ministry of Economy and the proposed documents are being edited.

Combating Corruption

In the second quarter the activities for combating corruption continued. Several concrete steps were undertaken to this effect, one of the most significant of them relating to the reform in the judiciary system, which, generally speaking, is taking place with difficulty and at a slow pace.

In June the Parliament started considering a draft-act on the ombudsman. Resolving the issues related to the regulation of the ombudsman's activity is of significant importance in the process of supervision over the government administration and reducing corruption in this sphere. Further on, the establishing of such an institution is required also by the EU. The proposals, which are being considered, provide for the ombudsman to be elected by the Parliament for a 5-year term of office. Criteria, which candidates for ombudsman should meet, are listed, as well as the institutions and persons that may nominate them.

In the beginning of June the government approved the rules for operation of the **anti-corruption commission**, which was established in February. The purpose of the commission will be to analyze information about anti-corruption actions taken by government bodies. The commission receives a lot of signals about corruption actions, and its work is mainly related to finding evidence proving the signals about taking bribes.

The joint efforts of the Bulgarian government and **various institutions and international programs in the process of combating corruption** continue:

In the beginning of June the US Agency for International Development presented its anti-corruption program Open Governance. This program has been negotiated during the visit of Bulgaria's Prime Minister to the General Assembly of the UN last year, and in April this year a framework agreement was signed for cooperation between the American and Bulgarian government, the above mentioned Program being a part of this Agreement. The program foresees technical assistance amounting to USD 6.8 million over the next three years. The assistance will be granted to the Audit Office and the Public Procurement Directorate of the Council of Ministers to support the anti-corruption activities of the government. A part of the Program includes support for the civil society and reducing the tolerance to corruption practices, and in particular, support for the activities of Coalition 2000.

Expected results are as follows: achieving better transparency in the work of the government administration and intolerance of society to corruption practices.

Judiciary System

In June the Parliament passed at first reading the **Act on amendments to the Judiciary Branch Act**. In July this Draft-Act was passed at second reading.

Some of the amendments provide for a limitation on the term-of-office number for the magistrates on management positions in the judiciary system, magistrates evaluation to be introduced, all magistrates to file affidavits of their property, preparation of annual reports on the work of the three components of the justice system, as well as the National Investigation Service to be reinstated. The effect of the above amendments will be manifested in the reduced number of court instances, which pass adjudication on a case, reducing the time available for the development of a penal or civil proceedings case, synchronization of the functions of the different components of the judiciary system.

The suggested amendments will probably not resolve completely the problems with the judiciary system, however, they are important because they settle the statute and plight of the judiciary branch. The purpose is the activities of the judicial authorities to become as transparent for society as possible, because a closed judiciary system is an environment favorable for corruption.

APPENDIX 1

Main indicators for the second quarter of 2002

Economic dynamics	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Industry														
Industrial production, volume index, previous month =100, %														
2002	86,5	118,8	114,9	104,5	99,1	104,2							-	-
2001	79,3	110,5	111,1	89,9	103,6	106,3	103,6	105,3	101,9	106,2	106,6	106,5	-	-
Industrial production, volume index, corresponding month of the previous year = 100, %														
2002	97,1	100,1	97,5	115,5	105,3	103							-	-
2001	93,5	128	102,1	101,6	104	100,2	106,8	110,3	102,7	99,3	101,3	95	-	-
Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %														
2002	97,1	97,3	96,9	101,3	102,1	101,5							-	-
2001	93,5	111,9	102,5	103	102,4	101,7	102	102,6	102,2	101,5	102,4	100,7	-	-
Industrial sales, total, volume index, previous month =100, %														
2002	84	99,6	110	109,3	92,8	108,5							-	-
2001	80	103,5	105,4	90,3	105,4	100,5	101,7	99,8	97,1	106,8	97,6	101,9	-	-
Industrial sales, total, corresponding month of the previous year = 100, %														
2002	91,8	88	89,1	106,3	94,3	100,1							-	-
2001	112,8	105,7	99,8	104,3	103,9	97,4	102,3	99,1	95,4	96,7	92,8	92,7	-	-
Industrial sales, total, from the beginning of the year, volume index, corresponding period of the previous year = 100, %														
2002	91,8	90,3	89,4	93,8	94	94,5							-	-
2001	112,8	109,2	104,9	104,6	104,4	103,1	103,2	102,8	101,9	101,2	100,6	99,4	-	-
Inflation														
Inflation (Consumer price index - 100), previous month =100, %														
2002	2,7	1,6	0,8	-0,1	-2,1	-1,7	0,1						-	-
2001	0,6	0,3	0,1	-0,2	0,1	-0,1	-0,2	0,3	1,3	1,7	0,2	0,6	-	-
Inflation (Consumer price index - 100), December of the previous year = 100, %														
2002	2,7	4,4	5,2	5,1	2,9	1,1	1,2						-	-
2001	0,6	1	1	0,8	0,9	0,8	0,6	0,9	2,2	4	4,2	4,8	-	-
Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %														
2002	7,0	8,4	9,2	9,2	6,9	5,2	5,5						8,2	7,1
2001	9,3	8,5	8,9	9,8	9,7	9,4	8,5	5,7	4,7	5,2	4,6	4,8	8,9	9,6

Employment and unemployment	I	I-II	I-III	I-IV	I-V	I-VI	I-VII	I-VIII	I-IX	I-X	I-XI	I-XII	Q1	Q2
Unemployed persons registered, total, end of the period, number														
2002	687 805	683 894	668 972	678 637	673 803	659 032	653 329						668 972	659 032
2001	708 729	713 761	704 691	707 793	678 528	654 008	643 528	637 831	629 866	637 348	656 976	662 260	704 691	654 008
Unemployment (Employment Agency, ratio to the economically active population from the population census in 1992), end of the period, %														
2002	17,99	17,89	17,5	17,75	17,63	17,24	17,09						17,5	17,24
2001	18,54	18,67	18,43	18,51	17,75	17,11	16,83	16,68	16,48	16,67	17,18	17,32	18,43	17,11
Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %														
2002	18,57	18,46	18,06	18,32	18,19	17,79	17,64						18,06	17,79
2001	19,13	19,27	19,02	19,11	18,32	17,66	17,37	17,22	17,00	17,21	17,74	17,88	19,02	17,66
Newly opened vacant jobs, end of the period, number														
2002	1 588	4 177	3 284	3 420	2 437	2 055	2 011						3 284	2 055
2001	2 587	2 908	3 903	2 287	3 732	4 236	2 210	2 170	2 246	2 212	1 569	1 268	3 903	4 236
Employed person, total, average for the period, number														
2002	1 889 012	1 894 154	1 905 647	1 905 159	1 920 609	1 930 386							1 896 271	1 930 386
2001	1 851 914	1 854 770	1 866 572	1 881 996	1 904 129	1 916 922	1 901 499	1 890 120	1 896 077	1 912 239	1 903 452	1 878 849	1 857 752	1 916 922
Employed person, public sector, average for the period, number														
2002	762 773	763 330	761 695	749 826	745 729	743 092							762 599	743 092
2001	803 322	804 038	802 894	782 409	781 331	778 545	770 832	765 341	767 022	766 079	769 087	768 207	803 418	778 545
Employed person, private sector, average for the period, number														
2002	1 126 239	1 130 824	1 143 952	1 155 333	1 174 880	1 187 294							1 133 672	1 187 294
2001	1 048 592	1 050 732	1 063 678	1 099 587	1 122 798	1 138 377	1 130 667	1 124 779	1 129 055	1 146 160	1 134 365	1 110 642	1 054 334	1 138 377
Fiscal review														
	I	I-II	I-III	I-IV	I-V	I-VI	I-VII	I-VIII	I-IX	I-X	I-XI	I-XII	Q1	Q2
State budget														
Revenues of the Consolidated State Budget, total, BGN million														
2002	889,1	1 752,7	2 782,3	3 974,5	5 156,1	6 086,9							2 782,3	3 304,6
2001	852,2	1 605,4	2 775,9	4 017,6	5 107,0	6 062,1	7 066,5	7 897,7	8 705,3	9 708,8	10 617,7	11 837,9	2 775,9	3 286,2
Expenditures of the Consolidated State Budget, total, BGN million														
2002	1 020,3	1 905,9	2 821,1	3 885,4	4 816,5	5 777,7							2 821,1	2 956,6
2001	1 091,8	1 968,8	2 897,2	3 901,0	4 888,5	5 895,1	7 116,1	7 979,0	8 846,9	9 709,1	10 620,7	12 093,1	2 897,2	2 997,9
Consolidated State Budget deficit (-) /surplus (+), BGN million														
2002	-131,2	-153,2	-38,8	89,1	339,6	309,1							-38,8	347,9
2001	-239,6	-363,4	-121,2	116,6	218,6	167,0	-49,6	-81,3	-141,6	-0,3	-3,0	-255,2	-121,2	288,2
Revenues of the Republican Budget, total, BGN million														
2002	521,9	985,5	1 585,0	2 332,0	3 042,6	3 556,7							1 585,0	1 971,7
2001	462,5	872,5	1 550,6	2 258,5	2 879,4	3 358,3	3 884,4	4 334,9	4 764,0	5 322,4	5 816,6	6 525,9	1 550,6	1 807,7
Expenditures of the Republican Budget, total, BGN million														
2002	367,7	869,5	1 139,2	2 382,7	2 848,5	3 374,8							1 139,2	2 235,6
2001	832,5	1 294,6	1 774,1	2 356,6	2 898,0	3 524,7	4 332,2	4 803,8	5 319,5	5 732,0	6 225,0	7 186,0	1 774,1	1 750,6
Republican Budget cash deficit (-) / surplus (+), BGN million														
2002	154,2	116,0	208,9	-50,7	194,1	181,9							208,9	-27,0
2001	-370,0	-422,1	-223,5	-98,1	-18,5	-166,5	-447,8	-468,9	-555,4	-409,6	-408,3	-660,2	-223,5	57,0

	I	I-II	I-III	I-IV	I-V	I-VI	I-VII	I-VIII	I-IX	I-X	I-XI	I-XII	Q1	Q2
Government and government guaranteed debt														
Government and government guaranteed debt, BGN million														
2002	20 993	20 917	20 859	20 103	19 502	18 855							20 859	18 855
2001	20 486	20 458	21 058	20 612	21 610	21 797	21 198	20 367	19 846	20 041	20 709	20 752	21 058	21 797
Domestic government and government guaranteed debt, BGN million														
2002	1 897	1 890	1 917	1 927	1 908	1 949							1 917	1 949
2001	1 717	1 706	1 743	1 733	1 752	1 767	1 769	1 738	1 767	1 813	1 821	1 861	1 743	1 767
Foreign government and government guaranteed debt, BGN million														
2002	19 096	19 027	18 942	18 176	17 594	16 906							18 942	16 906
2001	18 769	18 752	19 315	18 879	19 859	20 029	19 429	18 629	18 080	18 228	18 888	18 892	19 315	20 029
Government and government guaranteed debt, ratio to the annual GDP, %														
2002	68,2	68,0	67,8	65,3	63,4	61,3							67,8	61,3
2001	72,6	72,5	74,7	73,1	76,6	77,3	75,1	72,2	70,4	71,0	73,4	73,6	74,7	77,3
Domestic government and government guaranteed debt, ratio to the annual GDP, %														
2002	6,2	6,1	6,2	6,3	6,2	6,3							6,2	6,3
2001	6,1	6,0	6,2	6,2	6,2	6,3	6,3	6,2	6,3	6,4	6,5	6,6	6,2	6,3
Foreign government and government guaranteed debt, ratio to the annual GDP, %														
2002	62,0	61,8	61,5	59,0	57,2	54,9							61,5	54,9
2001	66,5	66,5	68,5	66,9	70,4	71,0	68,9	66,0	64,1	64,6	67,0	67,0	68,5	71,0
Domestic government debt, total, BGN million														
2002	1 891	1 884	1 912	1 922	1 903	1 945							1 912	1 945
2001	4 176	4 148	4 371	1 724	1 742	1 758	1 760	1 730	1 759	1 806	1 814	1 854	4 371	1 758
Debt on Government Securities issued for budget deficit financing, BGN million														
2002	1 144	1 139	1 172	1 198	1 201	1268							1 172	1 268
2001	932	931	946	943	923	941	966	968	997	1 042	1 042	1 077	946	941
Debt on Government Securities issued for structural reform, BGN million														
2002	746	745	740	724	702	677							740	677
2001	770	766	796	740	820	816	795	763	763	764	772	777	796	816
Domestic government guarantees, BGN million														
2002	6	6	6	5	5	4							6	4
2001	10	10	10	9	10	9	9	8	7	7	7	7	10	9
Foreign government debt, USD million														
2002	7 925	7 921	7 920	7 840	7 963	8 096							7 920	8 096
2001	8 472	8 421	8 290	8 275	8 145	8 187	8 176	8 221	7 942	7 931	8 103	8 006	8 290	8 187
Foreign government guaranteed debt, USD million														
2002	508	496	529	532	508	526							529	526
2001	446	446	433	434	465	497	503	502	499	496	490	507	433	497

Foreign economic relations and foreign investments														
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Balance of Payments														
Current account, USD million														
2002	-130	-50	-53	-135	-99	86							-233	-148
2001	-136	-39	-46	-78	-90	-2	-75	84	-46	-114	-156	-146	-221	-170
Exports (FOB), USD million														
2002	384	409	408	425	402	428							1 201	1 255
2001	397	429	456	412	392	429	454	448	425	455	452	364	1 282	1 233
Imports (FOB), USD million														
2002	466	482	500	571	590	535							1 448	1 696
2001	477	475	554	531	556	599	658	551	507	633	615	537	1 506	1 686
Trade balance, (FOB), USD million														
2002	-82	-73	-92	-147	-188	-107							-247	-442
2001	-80	-45	-99	-119	-164	-170	-204	-103	-82	-178	-164	-174	-224	-453
Capital account, USD million														
2002	0	0	0	0	0	0							0	0
2001	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Financial account, USD million														
2002	-3	10	110	352	299	155							117	806
2001	-49	36	-184	182	71	126	97	-68	109	260	497	-65	-197	379
Direct investment in Bulgaria, USD million														
2002	20	26	71	88	33	-9							117	112
2001	173	53	49	36	7	63	64	23	27	0	85	116	275	106
Finance														
Financial indicators														
Exchange rate BGN / USD, average for the period														
2002	2,21474	2,24804	2,23369	2,20959	2,13121	2,04781	1,97152						2,23216	2,12954
2001	2,08480	2,12230	2,15127	2,19193	2,23394	2,29254	2,27299	2,17258	2,14128	2,15933	2,20198	2,19164	2,11946	2,23947
Exchange rate BGN / USD, end of the period														
2002	2,26448	2,26081	2,24190	2,17121	2,08355	1,96073	1,99921						2,24190	1,96073
2001	2,10463	2,11487	2,21448	2,16761	2,30640	2,30640	2,23396	2,13565	2,14197	2,16305	2,19806	2,21926	2,21448	2,30640
Basic interest rate, end of the period														
2002	4,87	4,62	4,43	3,92	3,71	3,67	3,79						4,43	3,67
2001	4,35	4,28	4,22	4,15	4,36	4,47	4,55	4,75	4,76	4,63	4,79	4,65	4,22	4,47
Money (M1), BGN million														
2002	4 443,1	4 452,9	4 382,1	4 303,8	4 171,8	4 228,9							4 382,1	4 228,9
2001	3 544,1	3 590,2	3 555,1	3 645,9	3 794,9	3 834,4	3 956,4	3 984,2	4 030,1	4 052,8	4 103,8	4 664,7	3 555,1	3 834,4
Money (M2), BGN million														
2002	11 255,2	11 173,7	11 201,6	11 154,5	10 930,2	10 936,8							11 201,6	10 936,8
2001	9 060,2	9 203,4	9 204,3	8 863,4	9 186,3	9 372,2	9 721,6	9 855,3	10 004,3	10 175,0	10 273,7	11 226,1	9 204,3	9 372,2
International reserves of BNB, BGN million														
2002	7 372,4	7 373,0	7 196,2	7 427,8	7 546,3	7 908,4	8 034,3						7 196,2	7 908,4
2001	6 889,5	6 820,3	6 820,0	6 862,6	6 939,2	7 010,7	6 802,7	6 687,8	6 683,4	6 986,5	7 701,4	7 943,0	6 820,0	7 010,7
Fiscal reserves at the Issue Department of BNB, BGN million														
2002	2 276,2	2 260,4	2 106,5	2 358,9	2 803,3	3 020,8	3 065,5						2 106,5	3 020,8
2001	2 388,9	2 260,4	2 329,1	2 878,9	2 863,9	2 925,3	2 418,6	2 304,3	2 129,4	2 440,4	2 913,2	2 571,2	2 329,1	2 925,3

Banking system													
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	
Credits granted to non-financial institutions and other customers, total, end of the period, BGN thousand													
2002	4 226 013	4 267 336	4 354 165	4 527 779	4 651 472	4 769 243							4 354 165
2001	3 040 998	3 037 279	3 169 673	3 285 333	3 383 689	3 426 012	3 519 280	3 601 196	3 808 035	3 994 028	4 143 907	4 145 865	3 169 673
Credits granted to the budget, end of the period, BGN thousand													
2002	5 505	6 739	7 291	7 031	7 314	6 871							7 291
2001	3 396	5 199	5 870	5 042	4 707	4 023	4 195	4 648	91 972	145 710	149 712	5 772	5 870
Credits granted to state owned companies, end of the period, BGN thousand													
2002	164 898	156 145	161 650	201 201	203 441	193 604							161 650
2001	111 436	118 284	122 139	121 285	122 095	130 020	140 881	128 437	121 422	120 827	117 572	148 273	122 139
Credits granted to private companies, end of the period, BGN thousand													
2002	3 220 930	3 255 827	3 312 957	3 409 601	3 508 806	3 601 207							3 312 957
2001	2 360 768	2 343 920	2 434 243	2 518 381	2 582 162	2 586 954	2 640 167	2 709 482	2 818 212	2 926 183	3 055 534	3 159 490	2 434 243
Credits granted to individuals and households, end of the period, BGN thousand													
2002	834 680	848 625	872 267	909 946	931 911	967 561							872 267
2001	565 398	569 876	607 421	640 625	674 725	705 015	734 037	758 629	776 429	801 308	821 089	832 330	607 421
Credits granted to the budget, % of the total													
2002	0,13	0,16	0,17	0,16	0,16	0,14							0,17
2001	0,11	0,17	0,19	0,15	0,14	0,12	0,12	0,13	2,42	3,65	3,61	0,14	0,19
Credits granted to state owned companies, % of the total													
2002	3,90	3,66	3,71	4,44	4,37	4,06							3,71
2001	3,66	3,89	3,85	3,69	3,61	3,80	4,00	3,57	3,19	3,03	2,84	3,58	3,85
Credits granted to private companies, % of the total													
2002	76,22	76,30	76,09	75,30	75,43	75,51							76,09
2001	77,63	77,17	76,80	76,66	76,31	75,51	75,02	75,24	74,01	73,26	73,74	76,21	76,80
Credits granted to individuals and households, % of the total													
2002	19,75	19,89	20,03	20,10	20,03	20,29							20,03
2001	18,59	18,76	19,16	19,50	19,94	20,58	20,86	21,07	20,39	20,06	19,81	20,08	19,16
Total assets, end of the period, BGN thousand													
2002	12 340 044	12 286 166	12 710 381	12 722 090	12 473 976	12 394 798							12 710 381
2001	10 030 490	10 009 095	10 793 278	10 421 043	10 951 545	11 103 981	11 156 644	11 199 882	11 440 501	11 411 506	11 545 701	12 220 529	10 793 278
Total liabilities , end of the period, BGN thousand													
2002	10 676 646	10 602 225	11 014 662	11 040 181	10 782 330	10 682 602							11 014 662
2001	8 510 363	8 470 980	9 143 456	8 731 672	9 462 114	9 609 537	9 623 763	9 640 825	9 878 415	9 819 659	9 937 092	10 565 823	9 143 456
Interest revenues, BGN thousand													
2002	56 711	110 773	168 685	224 465	283 518	342 850							168 685
2001	55 742	107 205	163 567	220 524	279 833	336 002	395 993	453 631	509 521	568 718	625 241	686 760	163 567
Current profit/loss, BGN thousand													
2002	25 913	47 270	56 996	80 116	112 082	132 715							56 996
2001	25 980	43 653	157 588	183 083	197 758	203 302	229 939	255 411	274 876	292 643	309 412	319 375	157 588

Social policy and industrial relations														
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Wage&Salary														
Average Monthly Wage&Salary of employees under labor contract, total, nominal, BGN														
2002	250	252	265	262	269	264							256	265
2001	231	228	239	248	254	254	249	248	256	253	255	270	233	252
Average Monthly Wage&Salary of employees under labor contract, public sector, nominal, BGN														
2002	282	286	304	298	318	311							291	309
2001	257	254	271	281	300	295	287	284	307	287	293	316	261	292
Average Monthly Wage&Salary of employees under labor contract, private sector, nominal, BGN														
2002	228	230	238	238	237	234							232	236
2001	211	208	214	223	222	225	222	224	221	230	229	238	211	223
Real Average Monthly Wage&Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %														
2002	1,2	2,0	1,6	-3,3	-0,9	-1,2							1,6	-1,8
2001	6,2	3,5	1,2	3,6	2,9	4,1	2,9	5,7	4,1	7,4	4,2	4,7	3,6	3,5
Real Average Monthly Wage&Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %														
2002	2,6	3,9	2,8	-2,9	-0,8	0,2							3,1	-1,2
2001	6,4	5,5	2,4	4,9	6,0	7,5	6,7	8,8	7,8	10,0	5,3	5,8	4,7	6,1
Real Average Monthly Wage&Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %														
2002	1,0	2,0	1,9	-2,3	-0,1	-1,1							1,6	-1,2
2001	7,8	3,6	2,4	4,1	3,2	3,4	1,3	4,9	3,0	6,1	4,7	5,6	4,6	3,6
Income and consumption of the households														
Total income, monthly, average per person, nominal, BGN														
2002	113	113	126	131	137	135							117	134
2001	106	99	112	118	122	122	124	126	127	126	127	153	106	121
Cash income, monthly, average per person, nominal, BGN														
2002	109	110	121	122	123	124							113	123
2001	102	96	107	109	111	112	112	114	115	114	112	126	102	111
Total expenditure, monthly, average per person, nominal, BGN														
2002	109	112	120	124	136	131							114	130
2001	105	95	107	114	121	115	120	123	126	125	122	147	102	117
Cash expenditure, monthly, average per person, nominal, BGN														
2002	106	109	115	116	123	119							110	119
2001	101	92	102	105	110	105	108	111	114	113	107	121	98	107
Real total income, average per person, growth, corresponding period of the previous year =100, %														
2002	-0,4	5,3	3,1	1,6	5,0	5,5							2,7	4,0
2001	-2,9	-2,8	-2,3	-1,8	1,0	3,6	-4,4	6,8	3,3	3,3	0,0	-10,5	-2,6	0,9
Real cash income, average per person, growth, corresponding period of the previous year =100, %														
2002	-0,1	5,7	3,6	2,5	3,7	4,8							3,1	3,6
2001	-1,7	-2,7	-1,0	-0,2	1,8	4,4	-4,4	8,6	4,5	4,6	1,8	-10,6	-1,8	2,0
Real total expenditure, average per person, growth, corresponding period of the previous year =100, %														
2002	-3,0	8,8	-0,4		5,1	8,0							2,7	4,2
2001	2,2	-7,7	-5,7	-2,5	1,1	1,2	-2,8	3,4	1,6	2,5	-1,6	-6,4	-3,8	-0,1
Real cash expenditure, average per person, growth, corresponding period of the previous year =100, %														
2002	-1,9	9,3	3,3	1,1	4,6	7,7							3,4	4,4
2001	2,6	-6,7	-4,7	-1,9	1,9	2,9	-1,6	4,7	3,6	2,7	0,0	-4,7	-2,9	0,9

GDP for 2002 estimated by MoF and BNB: 30783 BGN million (14165 USD million)

Acronyms:

GDP = Gross domestic product

" - " = Not applicable or missing data

Sources: Bulgarian National Bank, Employment Agency, Ministry of Finance, National Statistical Institute

APPENDIX 2**PUBLICATIONS IN THE OFFICIAL GAZETTE
THROUGHOUT THE QUARTER**

Title	Status	The Official Gazette
REGULATION on the Application of the Disabled Individuals' Protection, Rehabilitation and Social Integration Act (DIPRSIA)	Adopted amendment	NO. 35 OF 5.04.2002
ORDER No. 70 of the MLSP of 3.04.2002 on Validation of an Application-affidavit Form for Receiving One-time Allowance for Giving Birth to a Child, in Compliance with Article 6 of the Children Allowances Act; Application-affidavit Form for Receiving Monthly Allowances for Children of Age up to 18 Years, in Compliance with Article 7 of the Children Allowances Act ; Application-affidavit Form for Receiving Monthly Allowances for Bringing up a Child up to 1 year Age, in Compliance with Article 8 of the Family Allowances Act	New	NO. 35 OF 5.04.2002
ORDINANCE on the Conditions and Order for Government Participation in the Payment of the Water-supply Service Cost	New	NO. 39 OF 16.04.2002
ORDINANCE on the Conditions and Order for Access of Privileged Users and Natural Gas Production Companies to the Gas Transmission and/or Gas Distribution Networks.	New	NO. 39 OF 16.04.2002
ORDINANCE on the Conditions and Order for Access of Privileged Users and Independent Producers of Electric Power to the Power Transmission and Power Distribution Networks.	New	NO. 39 OF 16.04.2002
ORDINANCE No. 3 of 1999 on Establishing and Keeping an Agricultural Producers Register.	Adopted amendments	NO. 39 OF 16.04.2002
ORDERS by the Ministry of Health Regarding the Threshold Prices of Medicinal Preparations	New	NO. 39 OF 16.04.2002
REGULATION on the Organization and Operation of the Supreme Advisory Water Council	New	NO. 39 OF 16.04.2002
ORDINANCE on the Requirements to Labeling and Presentation of Foodstuffs	Adopted amendments	NO. 40 of 19.04.2002
ORDINANCE No. 3 of 17.04.2002 on the Conditions and Order for Registration and the Requirements to the Activities of Currency Exchange Offices	New	NO. 41 of 23.04.2002
ORDINANCE No. 9 on the Requirements to Fresh Fruit and Vegetables Quality and Compliance Control	New	NO. 42 OF 24.04.2002
REGULATION on the Application of the Value Added Tax Act	Adopted amendments	NO. 43 OF 26.04.2002
Public Procurement ACT	Adopted amendments	NO. 43 OF 26.04.2002

ORDINANCE No. 10 of 18.04.2002 on the Maximum Admissible Radioactive Contamination upon Import of Agricultural Produce after the Chernobyl Nuclear Power Plant Accident	New	NO. 44 OF 29.04.2002
ORDINANCE No. 11 of 18.04.2002 on Determining the Requirements to the Radioactive Contamination Limits for Foodstuffs in Case of Radioactive Accident	New	NO. 44 OF 29.04.2002
Bulgarian National Bank ACT	Adopted amendments	NO. 45 OF 30.04.2002
Currency ACT	Adopted amendments	NO. 45 OF 30.04.2002
Banking ACT	Adopted amendments	NO. 45 OF 30.04.2002
Social Assistance ACT	Adopted amendments	NO. 45 OF 30.04.2002
Classified Information Protection ACT	New	NO. 45 OF 30.04.2002
Taxation Proceedings Code	Adopted amendments	NO. 45 OF 30.04.2002
Mandatory Social Security CODE	Adopted amendments	NO. 45 OF 30.04.2002 ENTERED INTO FORCE ON 30.04.2002
DECREE No. 90 of the Council of Ministers of 26.04.2002 on Amendment to the Regulation on the Application of the Social Assistance Act	Adopted amendments	NO. 46 OF 7.05.2002
Waters ACT	Adopted amendments	NO. 47 of 11.05.2002
Compensatory Instruments Transactions ACT	New	NO. 47 OF 11.05.2002
Ores and Minerals ACT	Adopted amendments	NO. 47 OF 11.0.05.2002
Stomatologists' Professional Ethics CODE	New	NO. 49 OF 17.05.2002
ORDER No. ПД-07-272 of 29.12.2001 on Approval of Labor Accidents Statistics System, General Methodology and European Statistics of Labor Accidents	New	NO. 50 OF 18.05.2002 , ENTERED INTO FORCE ON 1.01.2002
ORDINANCE on Conditions and Order for Determining the State's Liability for Environmental Damages Caused by Actions or Lack of Action in Case of Privatization	Adopted amendments	NO. 51 OF 21.05.2002
DECREE No. 100 of 15.05.2002 on Structural Changes in the Health Care System	New	NO. 52 OF 23.05.2002 ENTERED INTO FORCE ON 1.06.2002
DECREE No. 218 of 29.11.1999 on Adoption of a Regulation on the Structuring of the Ministry of Health	Adopted amendments	NO. 52 OF 23.05.2002 ENTERED INTO FORCE ON 1.06.2002
DECREE No. 103 of 18.05.2002 on Determining a New Amount of Social Pension for Old Age	New	NO. 54 OF 31.05.2002
Employment Encouragement ACT	Adopted	NO. 54 OF 31.05.2002

	amendments	ENTERED INTO FORCE ON 1.12.2002
DECREE No. 102 of 18 May 2002 on Adoption of the List of Countries with Market Risk in Compliance with Article 5 Paragraph 1 of the Export Insurance ACT	New	NO. 54 OF 31.05.2002
ORDINANCE on the Capital Structure and the Ratio of Balance Assets and Liabilities of Pension Insurance Companies, on the Conditions for Taking Loans by Them, and for Maintaining Minimum Liquid Funds by the Pension Insurance Companies and Voluntary Pension Funds	Adopted amendments	NO. 54 OF 31.05.2002 ENTERED INTO FORCE ON 31.05.2002
ORDINANCE No. 12 of 21.05.2002 on the Norms for Maximum Admissible Content of Heavy Metals as Admixture in Foods	New	NO. 55 OF 4.06.2002
Ordinance on the Method and Order for Assessment of the Assets of Pension Funds and Pension Insurance Companies	Adopted amendments	NO. 55 OF 4.06.2002, ENTERED INTO FORCE ON 4.06.2002
Tourism ACT	New	NO. 56 OF 7.06.2002, ENTERED INTO FORCE ON 1.10.2002
Ordinance on Assignment of Conducting of Activities Relating to Preparation for Privatization or Post-privatization Control, Including Legal Representation	New	NO. 57 OF 11.06.2002
Ordinance on the Conditions and Order for Allocation and Spending of the Funds under the Fund for Covering the Privatization Costs with the Privatization Agency	New	NO. 57 OF 11.06.2002
Ordinance on Due Diligence Reports and Privatization Assessment and on the Procedure for Licensing of Assessors	New	NO. 57 OF 11.06.2002
DECREE No. 1 of the Council of Ministers dated 4 January 2002 on the Implementation of the 2002 State Budget of the Republic of Bulgaria	Adopted amendments	NO. 57 OF 11.06.2002, ENTERED INTO FORCE ON 11.06.2002
REGULATION on Amendments to the Regulation on Application of the Excise Duty Act	Adopted amendments	NO. 58 of 12.06.2002
ORDINANCE No. 4 of 31.05.2002 on the Order for Investment Abroad of the Assets of Pension Insurance Companies and Supplementary Pension Insurance Funds	New	NO. 59 of 14.06.2002
DECREE No. 116 of CoM of 06.06.2002 on Settling the Relations Ensuing from the Closing down of the Center for Mass Privatization	New	NO. 59 OF 14.06.2002
Commercial CODE	Adopted	NO. 61 OF 21.06.2002

	amendment	
Corporate Income Tax ACT	Adopted amendments	NO. 61 OF 21.06 2002, NO. 62 OF 25.06.2002
Natural Persons Income Tax ACT	Adopted amendments	NO. 61 OF 21.06.2002
Public Offering of Securities ACT	Adopted amendments	NO. 61 OF 21.06.2002
RESOLUTION No. 303 of 21.05.2002 of the Council of Ministers on Adoption of the Updated Policy for the Telecommunications Sector of the Republic of Bulgaria	New	NO. 61 OF 25.06.2002
Health Care Establishments ACT	Adopted amendments	NO. 62 OF 25.06.2002
State Fees and Charges ACT	Adopted amendments	NO. 62 OF 28.06.2002
REGULATION on Amendments to the Regulation on the Application of the Value Added Tax Act – Issued by the Minister of Finance	Adopted amendments	NO. 63 OF 28.06.2002
Public Health ACT	Adopted amendments	NO. 63 OF 28.06.2002
Safe Use of Nuclear Power ACT	New	NO. 63 OF 28.06.2002
ORDINANCE No. 12 of 18.06.2002 on the Quality Requirements to Surface Water destined for Drinking-Residential Supply	New	NO. 63 OF 28.06.2002
Covenant for Social Security between the Republic of Bulgaria and the Slovak Republic	New	NO. 63 OF 28.06.2002 ENTERED INTO FORCE ON 1.07.2002

A. REVIEW OF BULGARIAN ECONOMY

The present review of Bulgarian economy is an authentic expert product of the Center for Economic Development, which was made possible mostly owing to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.

The review of Bulgarian economy in the second quarter of the year contains detailed presentation of this past period, assessment of the period and subsequent trends. The review is explicitly focused on this quarter of the current year. Where necessary, significant events, facts and data of periods prior to or after the end of the quarter have been highlighted. Where possible three main types of data comparisons have been made: against the respective period of the preceding year, against the end of the preceding year, or against the end of the first quarter of the year. Again where possible, the dynamics within the quarter itself has been traced, too. At many points also the trend for the period until the end of the current year has been outlined.

The structure of the presentation above follows two principles simultaneously. First, the strive is towards giving a more comprehensive presentation of the subject matter areas, with prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience and interests of the experts and of the Center for Economic Development as a whole.

The review of Bulgaria's economy in the second quarter of the year 2002 starts with presentation of the findings of the business climate survey. The latest values of the Estat index of business climate are presented. On the basis of the results of the survey an analysis is made of the condition and prospects of the business environment in our country. The business surveys conducted by the NSI are presented immediately after that.

The overall dynamics of the economy in the second quarter of 2002 has been discussed against the background of the following basic categories: GDP, industry, inflation, and labor market. The fiscal review of the quarter starts with a presentation of the budget implementation. The fiscal review covers also the topics on taxes, customs duties, foreign debt and domestic debt. The privatization topic is followed by discussion on small and medium-size enterprises. The foreign economic relations followed by foreign investments are presented in statistical terms, and in their thematic relation, by means of data about the balance of payments and foreign trade. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria – energy, transport, high technology, communications, tourism and agriculture. The financial sector is discussed by means of the capital market and the banking system. The wide topic of social policy and industrial relations encompasses the matters of social security, employment and unemployment, income and living standards, and social partnership. The current problems of the health care reform are discussed briefly. The environmental policy is considered simultaneously as a specific component of the economic policy, factor for the economic environment and an indicator of certain trends in the development. The specialized analysis of the process of Bulgaria's accession with the EU is underpinned by the understanding that in the course of these negotiations often the most determinative components of economic policy are defined. There exists also a two-way interdependence between the competitiveness of the

Bulgarian economy at macro- and company level, and the status of the negotiations. That is why in the context of the review and general analysis of the Bulgarian economy in the second quarter the choice was made to lay down the emphasis on the negotiations for EU membership as the most significant aspect of the European integration process, which encompasses the adaptation and application of *acquis*.

An integral part of the presentation are the two appendices: the detailed table showing basic indices of the quarter (Appendix 1) and the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country, and were promulgated in the Official Gazette during the second quarter of the year (Appendix 2).

This work was finally completed on 30 August 2002.

B. SOURCES

Alongside with the conclusions from the large number of their own outputs and works, some of which are parts of concrete research projects, the experts of the Center for Economic Development have used statistical and other input information and data from the following sources:

- National Assembly
- Council of Ministers
- Ministry of Agriculture and Forestry
- Ministry of Finance
- Ministry of Economy
- Ministry of Regional Development and Public Works
- Ministry of Transport and Communication
- Ministry of Labor and Social Policy
- Ministry of the Environment and Water
- Bulgarian National Bank
- Bulgarian Stock Exchange – Sofia AD
- National Statistics Institute
- National Social Security Institute
- Employment Agency
- Small and Medium-size Enterprises Agency
- Privatization Agency
- State Insurance Supervision Agency
- State Energy Regulation Committee
- State Securities Commission
- Delegation of the European Commission
- European Union
- International Oil Exchange
- Official Gazette
- Other publications

The particular sources and publications are quoted at the respective places in the text.

C. THE *ESTAT* INDEX OF BUSINESS CLIMATE IN BULGARIA

The business climate survey is based on own original methodology, developed by a team of the Agency for Social and Marketing Surveys ESTAT and the Center for Economic Development. The more significant details are discussed below.

Methodology of the Sample

The survey was conducted among 388 companies. The sample is a two-level panel one (at the first level the companies are divided into groups by regions, and at the second level – according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices “number of employees” and “type of ownership”. The sample is guaranteed representative one at the level of companies in operation.

Methodology of the Registration

The information has been collected using the method of an inquiry at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign financial statement documents (managers, chief accountants, commercial or marketing directors).

The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three components. The questions from one to five included comprise Component I – “General Condition of the Company”; question six – Component II – “Investment Attitudes and Company’s Strategies”; questions seven and eight - Component III – “Business Environment”.

General Description of the Index Calculation

1. Preliminary Preparation

The preliminary preparation includes weighting of data according to the indices “economic sector” and “number of employees”, recoding and calculating values for the respective questions:

- Questions with one possible answer
The original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done in such a way that the scale to be from –2 (the lowest degree) to +2 (the highest degree).
- Multiple choice questions
These questions are recoded in advance in such a way that the possible answers are located symmetrically on both sides of the neutral point (the zero).

2. Calculation of the components

The index for each question (indicator) is calculated as a weighted average value.

Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investments, Attitudes and Company’s Strategies”; “Business Environment”) is calculated as a weighted average.

The first table above shows the values obtained for the three components and the integrated index.

3. Calculation of an integrated index

The integrated index is calculated as a weighted average of the three components. The weight for each of the components is determined by means of expert evaluation.

The Estat index of business climate assumes values from –100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate Index:

-100 to –61	very poor
-60 to –21	poor
-20 to +20	average
+21 to +60	good
+61 to +100	very good

Interpretation

All components (with no exception), as well as the integrated index assume values within the interval [-100, +100]. The set of tools allows to determine also the direction of the index. The difference between the values of questions: Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain point in time) and Q1 (assessment of the condition during the preceding period) is applied as a criterion for determining the direction.

Beside everything aforesaid about the methodology, in many cases throughout the text additional methodological and other related notes and comments are given.

CENTER FOR ECONOMIC DEVELOPMENT
1, Balsha Street, Block 9
Sofia 1408,
Telephone: +359 2 953 4204;
Fax: +359 2 953 3644;
e-mail: ced@ced.bg
Website: www.ced.bg
